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Report No. OIG-2004-171  
May 13, 2005

OFFICE OF THE INSPECTOR GENERAL OF THE  
DEPARTMENT OF DEFENSE

Management Accountability Review  
of the  
Boeing KC-767A Tanker Program

*We Believe*



~~Special Warning~~

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May 13, 2005

MEMORANDUM FOR DEPUTY SECRETARY OF DEFENSE

SUBJECT: Management Accountability Review of the Boeing KC-767A Tanker Program  
(Report No. OIG-2004-171)

On December 2, 2003, the Chairman of the Senate Armed Services Committee commended the Secretary and you for taking prompt action to task the Department of Defense Inspector General to conduct an independent assessment of the Boeing KC-767A Tanker Program. Subsequently, on November 19, 2004, Members of the Senate Armed Services Committee sent a letter to the Secretary requesting that the Inspector General conduct an accountability review of all members of the Department of Defense and the Department of the Air Force, both military and civilian, who participated in structuring and negotiating the proposed lease contract for the Boeing KC-767A Tanker Program, including the then-Secretary of the Air Force and the then-Assistant Secretary of the Air Force (Acquisition), to determine what happened, who was accountable, and what actions must be taken to prevent a situation like the Boeing KC-767A tanker aircraft lease from happening again.

The report addresses in Part I, what happened; in Part II, who was accountable; and in Part III, what actions must be taken to prevent a situation like the Boeing KC-767A tanker aircraft lease from happening again. The timeline included at Appendix B summarizes "what happened." The Under Secretary of Defense for Acquisition, Technology, and Logistics; the Secretary of the Air Force; the Assistant Secretary of the Air Force (Acquisition) and senior members of their respective staffs were accountable for the decisions associated with the tanker aircraft lease. Although required to do so by Department of Defense directive, these officials did not comply with the DoD 5000 series of guidance, the Federal Acquisition Regulation, and the Office of Management and Budget circulars during their efforts to lease Boeing KC-767A tanker aircraft; instead they focused on supporting a legislative decision to allow leasing tanker aircraft from Boeing rather than developing objective acquisition information that would have questioned, as a matter of procedure, whether such a decision was appropriate for the situation.

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. John E. Meling at (703) 604-9091 (DSN 664-9091) or Mr. Henry F. Kleinknecht at (703) 604-9324 (DSN 664-9324).

Thomas F. Gimble  
Deputy Inspector General  
as First Assistant

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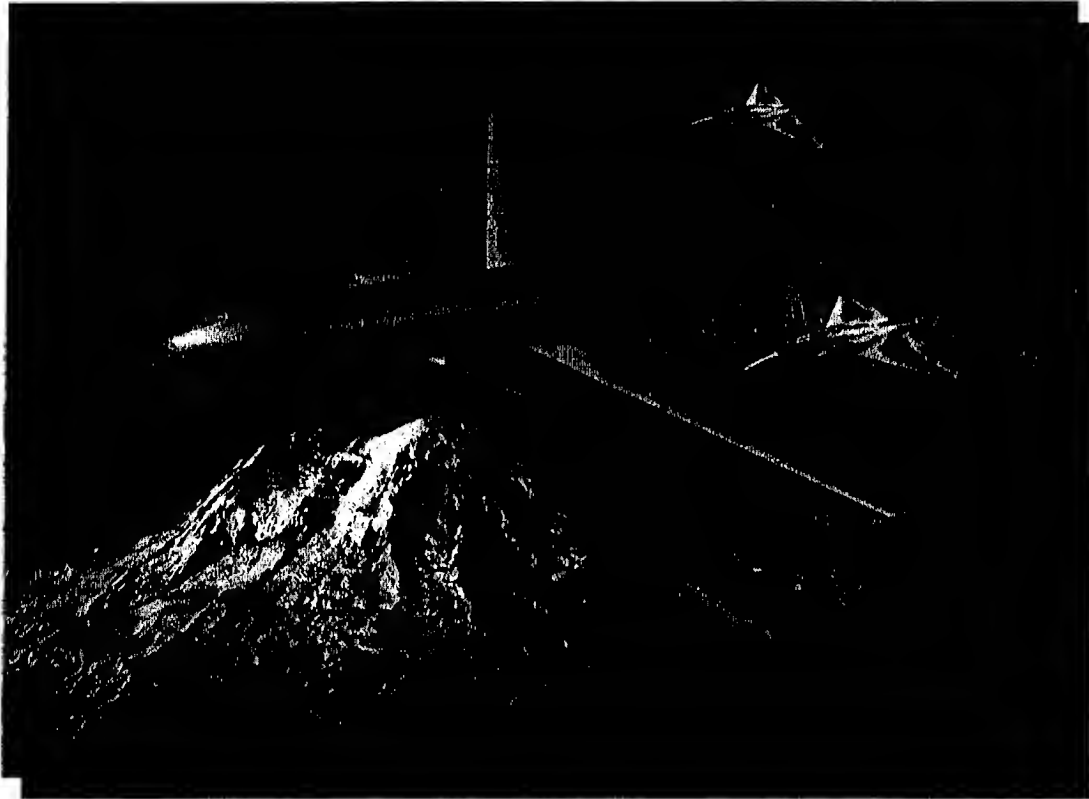
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Source: Office of the Assistant Secretary of the Air Force (Acquisition)

**Proposed Boeing KC-767A Tanker Aircraft**

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**Office of the Inspector General of the Department of Defense**

**Report No. OIG-2004-171**  
(Project No. D2005AE-0092)

**May 13 2005**

**Management Accountability Review of the  
Boeing KC-767A Tanker Program**

**Executive Summary**

**Objective of the Review.** Our overall objective of the review of the Boeing KC-767A Tanker Program was to determine what happened, who was accountable, and what actions must be taken to prevent a similar situation from happening again.

**Scope and Methodology.** To accomplish the objective, the review team analyzed selected e-mails and memorandums from the Department of Defense and the Boeing Company; interviewed members of the Office of the Secretary of Defense and the Department of the Air Force, both military and civilian, including the then-Secretary of the Air Force and the then-Assistant Secretary of the Air Force (Acquisition), who were involved in the Boeing KC-767A tanker aircraft lease; and evaluated prior Department of Defense Office of the Inspector General reviews of the Boeing KC-767A Tanker Program to gain insight into what happened and who was accountable during the structuring and negotiating of the proposed lease contract for the Boeing KC-767A Tanker Program. During the review, we included significant events along a timeline from inception of the idea until Congress terminated the Secretary of the Air Force authority to lease tanker aircraft (Appendix B).

**Results.** Senior officials of the Air Force acquisition community and the Office of the Secretary of Defense were focused on supporting a decision to lease tanker aircraft from Boeing rather than developing objective acquisition information that would have questioned, as a matter of procedure, whether such a decision was appropriate. Although required by Department of Defense directive, officials of the Office of the Secretary of Defense and the Air Force did not comply with the Office of Management and Budget circulars, the Federal Acquisition Regulation, and the DoD 5000 series of guidance to ensure that a tanker replacement aircraft was acquired to satisfy user needs with measurable improvements to mission capability and operational support, in a timely manner, and at a fair and reasonable price. Instead, the Air Force used Section 8159 of the Department of Defense Appropriations Act for FY 2002 to justify its inappropriate acquisition strategy with the primary goal to expeditiously lease 100 Boeing KC-767A tanker aircraft to replace its aging KC-135E tanker aircraft fleet. In doing so, as explained in DoD Inspector General Audit Report No. D-2004-064 of March 29, 2004, the Air Force "demonstrated neither best business practices nor prudent acquisition procedures to provide sufficient accountability for the expenditure of \$23.5 billion for the KC-767A tanker program."

**What Happened.** Although several studies and proposals covering the Air Force tanker and Boeing commercial aircraft occurred before September 2001, Air Force officials began meeting with Boeing Company executives to enter into an agreement to lease 100 Boeing KC-767A tanker aircraft in September 2001. The proposed agreement

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had support from White House officials, members of Congress, the Office of the Secretary of Defense, the Air Force, and the Boeing Company. At that time, the Air Force neither identified nor funded an urgent requirement for the replacement of the existing tankers.

On January 10, 2002, Section 8159 of the Department of Defense Appropriations Act for FY 2002 authorized the Air Force to make payments on a multiyear pilot program for leasing not more than 100 general purpose Boeing 767 aircraft for more than 10 years per aircraft, inclusive of any options to renew or extend the initial lease term. Further, the present value of the total payments over the duration of each lease can not be more than 90 percent of the fair market value of the aircraft obtained under the lease. Without conducting an analysis of alternatives, the Air Force used Section 8159 of the Department of Defense Appropriations Act for FY 2002 to justify an informal acquisition strategy, the focus and goal of which was to expeditiously lease 100 KC-767A tanker aircraft from Boeing through a business trust.

Decision makers in the Air Force and the Office of the Secretary of Defense undertook efforts to acquire this tanker capability without the benefit of key information on requirements and costs, which are derived from following established acquisition procedures. They made an inappropriate decision to only use Section 8159 for an acquisition strategy and bypassed following the prescribed procedures contained in DoD Directive 5000.1, "Defense Acquisition System." According to Dr. Marvin R. Sambur, Assistant Secretary of the Air Force (Acquisition), Mr. Edward C. "Pete" Aldridge, Jr., Under Secretary of Defense for Acquisition, Logistics, and Technology told him in November 2001 that the requirements of DoD Directive 5000.1 did not need to be implemented for the Boeing KC-767A tanker aircraft lease. By not following established acquisition procedures, the decision makers did not apply best business practices, adhere to prudent acquisition procedures, comply with statutory provisions for testing, and satisfy warfighter needs at a fair and reasonable price. Further, the Air Force considered the Boeing KC-767A tanker aircraft to be a commercial item even though significant modifications were required and no commercial market for this tanker aircraft existed to establish reasonable prices by the forces of supply and demand. As a result, and as explained in our earlier Report D-2004-064, the Air Force did not have sufficient cost or pricing data to demonstrate the level of accountability needed to conclude that the prices negotiated represented a fair expenditure of Department of Defense funds.

Because of revelations by The Boeing Company in November 2003 concerning apparent improprieties by the Boeing executives, Ms. Darleen A. Druyun (former Principal Deputy Assistant Secretary of the Air Force [Acquisition and Management]) and Mr. Michael Sears, Chief Financial Officer, Boeing; the Deputy Secretary of Defense placed the Boeing KC-767A Tanker Program on hold until our review and reviews by the National Defense University and Defense Science Board were completed. Our review concluded that the Air Force used an inappropriate acquisition strategy and demonstrated neither best business practices nor prudent acquisition procedures to provide sufficient accountability for the expenditure of \$23.5 billion for the Boeing KC-767A Tanker Program. In our prior Report D-2004-064, we identified five statutory provisions that the Air Force did not satisfy relating to: commercial items; testing (two statutes); cost-plus-a-percentage-of-cost system of contracting; and leases. Therefore, we recommended that DoD not proceed with the program until it resolved the issues pertaining to the procurement strategy, acquisition procedures, and statutory requirements.

In April 2004, the National Defense University issued a report concluding that the Air Force and the Department of Defense bypassed many elements of the normal

acquisition system and that the Office of the Secretary of Defense Leasing Review Panel was not a substitute for the Defense Acquisition Board review of the tanker lease acquisition. The National Defense University also concluded that the Air Force did not use a competitive process for the tanker lease acquisition because contractor selection was a foregone conclusion based on Section 8159 of the Department of Defense Appropriations Act for FY 2002 and the Joint Requirements Oversight Council. Also, in May 2004, the Defense Science Board concluded that the KC-135 airframe would be capable until 2040 and that a corrosion problem was manageable. The Board also commented on tanker recapitalization noting a need to embark on a major tanker recapitalization program, but because total tanker requirements are uncertain, the recapitalization program can be deferred until the completion of the analysis of alternatives and the Mobility Capabilities Study.

**Who Was Accountable.** The Boeing KC-767A Tanker Program had significant support from senior decision makers, including three of four congressional Defense committees. However, the Office of Management and Budget; the Congressional Budget Office; Program Analysis and Evaluation, Office of the Secretary of Defense; the Defense Science Board; the Defense Acquisition University; the then-Principal Deputy Under Secretary of Defense for Acquisition, Technology, and Logistics; and the Department of Defense Inspector General raised several significant “red flag” issues concerning the program. These issues included inappropriate lease type, improper item definition, lack of cost data, analyses that supported buy rather than lease, lack of an urgent requirement, and failure to follow prescribed acquisition rules.

Although Department of Defense and Air Force officials are responsible for overseeing the acquisition process, those officials did not properly follow acquisition policies and procedures. Specifically, senior acquisition officials are accountable for providing an effective, affordable, and timely system to the users, which in this case was the Assistant Secretary of the Air Force (Acquisition) and the Under Secretary of Defense for Acquisition, Technology, and Logistics. Before the Boeing KC-767A Tanker Program became an Acquisition Category ID or Major Defense Acquisition Program on May 23, 2003, the Secretary of the Air Force and the Assistant Secretary of the Air Force (Acquisition) did not require an analysis of alternatives to identify the best possible system solution to meet warfighter requirements and did not require a formal, written acquisition strategy to guide the program during system development and demonstration. The Assistant Secretary of the Air Force (Acquisition) allowed the Air Force to use Section 8159 of the Department of Defense Appropriations Act for FY 2002 to justify an inappropriate acquisition strategy. The Congress could have but did not prescribe in the legislation that the Air Force need not:

- follow DoD acquisition directives or
- comply with five statutory provisions of law, the Federal Acquisition Regulation, and the Department of Defense acquisition policy.

Further, when the Under Secretary of Defense for Acquisition, Technology and Logistics designated the Boeing KC-767A Tanker Program as a major Defense acquisition program on May 23, 2003, he did so without convening a Defense Acquisition Board to ensure that the program acquisition strategy adequately addressed the acquisition approach, warfighter capability needs, test and evaluation, risk management, resource management, funding under an evolutionary acquisition strategy, systems engineering, interoperability, information technology, information assurance, product support, human system integration, and business considerations. Instead, the Under Secretary based his



decision on the ongoing review by the Office of the Secretary of Defense Leasing Review Panel and by the Secretary of Defense approval of the proposed lease. The objective of the Leasing Review Panel, which was subordinate to the Defense Acquisition Board, was to advise and assist the Secretary of Defense in establishing an internal review and approval process to assess the impact of leasing proposals on the Defense budget. The objective was not to focus on program management and readiness of the program to proceed to the next phase of the acquisition process. While many people provided input into the tanker aircraft lease decision, we concluded that Mr. Edward C. Aldridge, Jr., Under Secretary of Defense for Acquisition, Technology, and Logistics; Dr. James G. Roche, Secretary of the Air Force; Dr. Marvin R. Sambur, Assistant Secretary of the Air Force (Acquisition); and Ms. Darleen A. Druyun, Principal Deputy Assistant Secretary of the Air Force (Acquisition and Management) were the primary decision makers within the Department of Defense and the Air Force who allowed the Boeing KC-767A tanker aircraft lease to continue moving forward. Additionally, Mr. Michael W. Wynne, as the Principal Deputy Under Secretary of Defense for Acquisition, Technology, and Logistics raised concerns about the unit price and the conduct of an analysis of alternatives. However, he did not require the Air Force to follow the DoD Directive 5000 series after assuming the acting duties of the Under Secretary of Defense for Acquisition, Technology, and Logistics.

**What Actions Must Be Taken To Prevent a Similar Situation.** The Office of Management and Budget circulars, the Federal Acquisition Regulation, and the DoD 5000 series of guidance establish a system of management controls over the acquisition of weapon systems for the Department. The system, when properly implemented and followed, should place needed capabilities in the hands of the warfighter while appropriately mitigating the level of risk associated with properly performing the actual functions expected of the weapon system. Also, the DoD 5000 series establishes a system of management controls to maintain proper financial control of the program to protect the interests of both the warfighter and the taxpayer when contemplating different weapons acquisition strategies to include leasing as a financing option. The system of management internal control was either not in place or not effective because the existing acquisition procedures were not followed in the proposed lease of the Boeing KC-767A tanker aircraft. The Department of Defense must change the cultural environment in its acquisition community to ensure that the proper control environment is reestablished and followed for major weapon-system acquisitions.

In addition, as part of the cultural change, the Department must not tolerate situations where senior officials use their positions to have contractors put pressure on other senior officials to have them change their stance relative to a particular situation. For example, on June 20, 2003, Mr. Kenneth J. Krieg, Director, Program Analysis and Evaluation issued a memorandum stating that purchase was more cost effective than leasing the Boeing KC-767A tanker aircraft and that the lease as proposed did not meet Office of Management and Budget requirements. Consequently, according to Boeing executives in an e-mail, Dr. Roche requested, in a meeting with them on June 23, 2003, that Boeing put pressure on Mr. Michael Wynne to have Mr. Krieg change his position on the Boeing KC-767A tanker aircraft lease.

Even though Department of Defense Instruction 5000.2, "Operation of the Defense Acquisition System," May 12, 2003, requires an analysis of alternatives at major milestone decision points for major Defense acquisition programs, the Office of the Secretary of Defense and the Department of the Air Force did not comply with the requirement because of guidance from Mr. Aldridge to Dr. Sambur that the requirements of DoD Directive 5000.1 did not need to be implemented for the Boeing KC-767A tanker

aircraft lease. Therefore, the Secretary should reemphasize the requirement to conduct an analysis of alternatives for all major Defense acquisition programs and major systems before major milestone decision points.

Further, the Under Secretary of Defense for Acquisition, Technology, and Logistics; the Assistant Secretary of Defense for Networks and Information Integration; and the Director, Operational Test and Evaluation should revise DoD Instruction 5000.2 to specify the procedures the Under Secretary of Defense for Acquisition, Technology, and Logistics and the Department of Defense Component Acquisition Executives must follow when leasing a major Defense acquisition program or a major system. Specifically, the guidance should emphasize that leasing is a method for financing the acquisition of a program and that the program should be treated the same as any acquisition program of like cost. Further, the guidance should require, at a minimum, that the acquiring Military Department prepare an analysis of alternatives for the lease and that the decision to enter into a contract to lease a major Defense acquisition program or a major system must be subject to the results of a Defense Acquisition Board or a System Acquisition Review Council review, as applicable.

**Management Comments and Audit Response.** We received comments from the Under Secretary of Defense for Acquisition, Technology, and Logistics and the Acting Secretary of the Air Force on the draft report. The Under Secretary stated that, by not acknowledging the expressed congressional approval for the Secretary of the Air Force to consider the lease of commercially configured tanker aircraft, the report seems to ignore the need for flexibility if the Department is to be capable of responding appropriately to an immediate requirement for a major end item. Further, he stated that the report implied that the mere consideration of an alternative to standard major systems acquisition practices was somehow wrong, even if congressionally permitted. The Under Secretary suggested that the Department devote more effort in the early stages of future innovative acquisitions to ensure a common appreciation of those transactions. While we are not opposed to acquisition reform initiatives, we believe that safeguards, such as conducting an analysis of alternatives and adhering to the Federal Acquisition Regulation and statutory testing requirements for items that do not meet the definition of a commercial item, need to be followed to ensure that warfighter needs are efficiently and effectively met and to protect the Government's and the taxpayers' interests.

In response to the draft report, the Acting Secretary concurred with the recommendations except the recommendation to legislate a requirement to conduct an analysis of alternatives. He stated that the requirement to conduct an analysis of alternatives was already contained in the DoD 5000 series of directives. Further, the Acting Secretary stated that "A statutory requirement would remove the agility the Defense Acquisition System requires in cases where a time imperative exists and the materiel solution is clear." For the Boeing KC-767A tanker aircraft, a time imperative did not exist, the materiel solution was not clear, and the Office of the Secretary of Defense and the Air Force did not follow the requirement to conduct an analysis of alternatives in the DoD 5000 series of directives. Therefore, the Secretary should reemphasize the requirement to conduct an analysis of alternatives for all major Defense acquisition programs and major systems before major milestone decision points. (See the Management Comments section of the report for the complete text of the comments.)

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## Background

**Objective of the Review.** Our overall objective in this review of the Boeing KC-767A Tanker Program was to determine what happened, who was accountable, and what actions must be taken to prevent an inappropriate acquisition and financial situation like the tanker lease from happening again.

**Request From the Senate Armed Services Committee.** On December 2, 2003, Chairman Warner of the Senate Armed Services sent a letter to the Deputy Secretary of Defense in which he commended the Secretary of Defense and the Deputy Secretary of Defense for their prompt actions regarding the Boeing KC-767A Tanker Program and for tasking the Department of Defense Inspector General to conduct an independent assessment of the Program. Chairman Warner indicated, however, that he believed that the independent assessment should also “examine the actions of all members of the Department of Defense and the Department of the Air Force, both military and civilian, top to bottom, who participated in structuring and negotiating the proposed tanker lease contract which was submitted to the Congress in July 2003.”

On November 19, 2004, Chairman Warner of the Senate Armed Services Committee, Ranking Senator Levin, and Senator McCain sent a letter to the Secretary of Defense, enclosing a copy of the Chairman’s December 2, 2003, letter, requesting that the Department of Defense Inspector General conduct an accountability review “of all members of the Department of Defense (DoD) and the Department of the Air Force, both military and civilian, top to bottom, who participated in structuring and negotiating the proposed tanker lease contract,” including the then-Secretary of the Air Force and the then-Assistant Secretary of the Air Force (Acquisition). Specifically, the accountability review should determine what happened, who was accountable, and what actions must be taken to prevent a situation like the tanker lease from happening again. See the following pages for the specific request from Chairman Warner, Ranking Senator Levin, and Senator McCain.

**Description of the Tanker Program.** The Boeing Company planned to produce the Boeing KC-767A tanker aircraft from its core commercial B767-200ER aircraft. The plan included integrating features from other B767 models and adding extensive military-unique modifications for its primary air refueling mission and other missions, including cargo, passenger, aeromedical evacuation, communication relay, and passive sensor. As a tanker, the aircraft was to receive and dispense fuel through a drogue and boom from its centerline and to store more than 200,000 pounds of fuel.

## Scope and Methodology

**Introduction.** To accomplish the objective, the review team analyzed selected e-mails and memorandums from the Department of Defense and the Boeing Company; interviewed members of the Office of the Secretary of Defense and the Department of the Air Force, both military and civilian, including the then-Secretary of the Air Force and the then-Assistant Secretary of the Air Force

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(Acquisition), who were involved in the Boeing KC-767A tanker aircraft lease; and used prior Department of Defense Office of the Inspector General reviews of the Boeing KC-767A Tanker Program to gain insight into what happened and who was accountable during the structuring and negotiating of the proposed lease contract for the Boeing KC-767A Tanker Program. Using the results of what happened (Part I) and who was accountable (Part II), the review team determined what actions must be taken to prevent a situation like the tanker lease from happening again (Part III).

**Interviews.** After analyzing selected e-mails, memorandums, and prior reviews of the Boeing KC-767A Tanker Program, the review team determined who in the Office of the Secretary of Defense and the Department of the Air Force, both military and civilian, were involved in the management of the program. Based on that determination, the review team interviewed 88 individuals in the Office of the Secretary of Defense and the Department of the Air Force to gain further insight into what happened and who was accountable during the structuring and negotiating of the proposed lease contract for the Boeing KC-767A Tanker Program. See Part II for excerpts of selected interviews and Appendix D for a list of the members of the Office of the Secretary of Defense and the Air Force who were interviewed.

**Timeline of Events.** Using the results of the analysis of selected e-mails and memorandums; interviews of members of the Office of the Secretary of Defense and the Air Force, who were involved in the Boeing KC-767A tanker aircraft lease; and evaluations of prior reviews, the review team developed a timeline that identified significant events from inception of the idea until Congress terminated the Secretary of the Air Force authority to lease tanker aircraft. See Appendix B for the timeline.

**Limitations.** The review team did not interview White House officials, members of Congress, and the Boeing Company because the focus of the review was on members of the Office of the Secretary of Defense and the Department of the Air Force, both military and civilian, who were involved in the Boeing KC-767A tanker aircraft lease. In addition, the review team was unable to interview Mr. Edward C. "Pete" Aldridge, Jr., former Under Secretary of Defense for Acquisition, Logistics, and Technology even after repeated attempts to contact him.

**HONORABLE DONALD H. RUMSFELD**  
Secretary of Defense  
1000 Defense Pentagon  
Washington, D.C. 20301-1000

**Dear Mr. Secretary:**

On December 2, 2003, Chairman Warner wrote to Deputy Secretary Wolfowitz to request that the Department of Defense Inspector General (DOD IG) conduct a thorough investigation of the KC-767A tanker aircraft program. According to Chairman Warner's letter "this inquiry should examine the actions of all members of the Department of Defense (DOD) and the Department of the Air Force, both military and civilian, top to bottom, who participated in structuring and negotiating the proposed tanker lease contract which was submitted to the Congress in July 2003." A copy of that letter is attached.

It was our understanding that the requested DOD IG review would assess not only individual responsibility for any allegations of criminal violations of law; but, equally important, individual accountability for management decisions and executive oversight. In essence, the Senate Committee on Armed Services, in order to conduct its necessary legislative oversight of the Department of Defense, needs to know what happened, who was accountable and what actions must be taken to prevent this situation from happening again.

It is astonishing to us that one individual could have so freely perpetrated, for such an extended period, this unprecedented series of fraudulent decisions and other actions that were not in the best interest of the Department of Defense.

We recently found out that no such managerial accountability review has been undertaken by the DOD IG. Rather, the DOD IG limited his review to determining whether there was evidence to press criminal charges. We are deeply concerned by this development. Given the Chairman's letter, why was a decision made not to do this work?

Congressional oversight of the proposed contract to lease 100 KC-767A tanker aircraft, a contract which is now prohibited by section 133 of the National Defense Authorization Act for Fiscal Year 2005, uncovered the most significant defense procurement scandal since the Ill Wind bribery and fraud cases of the 1980s. It is imperative that the Department take actions to hold those responsible accountable. Otherwise, the fallout from this Air Force procurement scandal will have disastrous effects on the integrity of the acquisition system.

OSD 18663-04

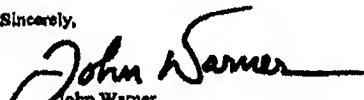
OSD 18663-04

In our view, an assessment of accountability should include a review of all members of the Department of Defense and the Department of the Air Force, both military and civilian, who participated in structuring and negotiating the proposed tanker lease contract. Most importantly, this should include Secretary of the Air Force Jim Roche, and Assistant Secretary of the Air Force Marvin Sambur. We reiterate the Committee's request that the DOD IG immediately initiate such an accountability review.

Again, we do not understand how one individual could have amassed so much power that she was able to perpetuate such fraud against the federal government and other actions that were not in the best interest of the Department of Defense. Where was the oversight? Where were the checks and balances? At a minimum, the acquisition chain of the Air Force, and perhaps DOD, was woefully inadequate. The fact that no Departmental review of these questions has been conducted raises significant accountability and oversight questions that go far beyond this one case. We trust you will endeavor to rectify the situation and hold those who are responsible accountable.

  
Carl Levin  
Ranking Member

Sincerely,

  
John Warner  
Chairman

  
John McCain  
U.S. Senator

Attachment

cc: Department of Defense Inspector General

JOHN WARNER, VIRGINIA, CHAIRMAN  
 JOHN DEDAMME, ARIZONA  
 JAMES M. BROWNE, COLORADO  
 PAT ROBERTS, KANSAS  
 WAYNE ALLARD, COLORADO  
 VIKI BECKING, ALABAMA  
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 JOHN STUBBS, MISSISSIPPI  
 JAMES H. TALMONT, MISSISSIPPI  
 RANDY CRAMER, GEORGIA  
 ROBERT C. GORDON, SOUTH CAROLINA  
 GLENN THOMAS, NORTH CAROLINA  
 JOHN CORNYN, TEXAS  
 CARL LEVIN, MICHIGAN  
 THOMAS M. CARPER, MASSACHUSETTS  
 ROBERT C. BYRD, WEST VIRGINIA  
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 JEFF BLUNT, MISSOURI  
 DANIEL H. AKAKA, HAWAII  
 BILL NELSON, FLORIDA  
 C. SCHUMMER, MISSISSIPPI, NE BRASKA  
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 JUDITH A. ANGLY, STAFF DIRECTOR  
 ROBERT D. GORDON, SENATE STAFF DIRECTOR

**United States Senate**  
 COMMITTEE ON ARMED SERVICES  
 WASHINGTON, DC 20510-8060  
 December 2, 2003

The Honorable Paul Wolfowitz  
 Deputy Secretary of Defense  
 1000 Defense Pentagon  
 Washington, D.C. 20301-1000

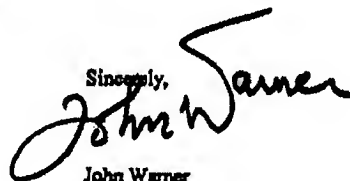
Dear Secretary Wolfowitz:

I commend the Secretary of Defense and yourself for the prompt actions you have taken regarding the Air Force's tanker aircraft program, in light of recent extraordinary personnel actions taken by the Boeing Company. Your decision to require a "pause" in the execution of any contracts to lease and purchase tanker aircraft is a prudent management step.

Further, I concur in your judgment to task the Department of Defense Inspector General (DOD-IG) to conduct an independent assessment. However, I believe that the DOD-IG assessment should go further than the review described in your letter of December 1, 2003. The DOD-IG inquiry should pursue the trail of evidence wherever it leads, in accordance with standard IG procedures. This inquiry should examine the actions of all members of the Department of Defense and the Department of the Air Force, both military and civilian, top to bottom, who participated in structuring and negotiating the proposed tanker lease contract which was submitted to the Congress in July 2003.

Your recent actions clearly indicate that there are many outstanding questions that must be answered before proceeding with this program. I expect that you will consult further with the Congress as you receive the report of the DOD-IG and that no actions will be taken with respect to the lease and purchase of KC-767 tanker aircraft until the Congress has had an opportunity to review the DOD-IG report. Ultimately, this program, as restructured, must be executed in a manner that is fully consistent with Section 135 of the National Defense Authorization Act for Fiscal Year 2004 (Public Law 108-136).

With kind regards, I am

Sincerely,  
  
 John Warner  
 Chairman

cc: Department of Defense Inspector General

U19766 /03

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## Part I – What Happened?

On November 19, 2004, Senators Warner, Levin, and McCain in a letter to Secretary of Defense Donald Rumsfeld requested that the Department of Defense Office of the Inspector General conduct an assessment of managerial accountability of the Boeing KC-767A Tanker Lease Program. Specifically, the Senators requested that the assessment address the questions, “what happened, who was accountable, and what actions must be taken to prevent this situation from happening again.”

The Boeing KC-767A Tanker Lease Program was championed by senior DoD and Air Force officials. In addition, Boeing Company officials provided an intense lobbying support in the White House, Congress, and DoD.

DoD acquisitions are required to follow the requirements for analysis and oversight that are in DoD Directive 5000.1, “The Defense Acquisition System,” May 12, 2003, and prior versions. The oversight mechanisms provide internal controls to ensure that the weapon systems acquired by DoD satisfy the needs of the warfighter and are acquired economically and efficiently using best business practices. When it is determined that a major acquisition program is warranted, the Senior Acquisition Executive<sup>1</sup> is required to notify Congress through formal reporting of a new start. When the acquisition program is established, the DoD and Air Force officials are responsible for ensuring the proper procedures are followed. Air Force and other DoD acquisition officials did not follow the proscribed procedures in DoD Directive 5000.1 for the tanker program. Dr. Marvin R. Sambur, Assistant Secretary of the Air Force (Acquisition) stated that Mr. Edward C. Aldridge, Jr., Under Secretary of Defense for Acquisition, Logistics, and Technology,<sup>2</sup> in November 2001, told him that the requirements of DoD Directive 5000.1 did not need to be implemented for the Boeing KC-767A tanker aircraft lease. As a result, many of the required oversight reviews, analyses and acquisition planning normally performed on acquisitions of this magnitude were not performed.

The Air Force did not identify tanker recapitalization as an immediate near-term requirement. Specifically, although the Air Force recognized that the tanker aircraft fleet, predominately KC-135 tanker aircraft, was aging and maintenance costs were likely to increase, the Air Mobility Command estimated in the Air Mobility Command Strategic Plan that the KC-135 tanker aircraft fleet

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<sup>1</sup>In the Military Departments, the Secretaries delegate their acquisition responsibilities to the Assistant Secretary level, commonly called the Service Acquisition Executive. For the Air Force, the Service Acquisition Executive is the Assistant Secretary of the Air Force (Acquisition), who reports to the Secretary of the Air Force administratively and to the Under Secretary of Defense for Acquisition, Technology, and Logistics for acquisition management matters. Each Service Acquisition Executive also serves as the Senior Procurement Executive for their Military Department. In this capacity, they are responsible for management direction of their respective Military Department procurement system.

<sup>2</sup>The Under Secretary of Defense for Acquisition, Technology, and Logistics serves as the Defense Acquisition Executive with responsibility for supervising the performance of the DoD Acquisition System and enforcing the policies and practices in DoD Directive 5000.1 and Office of Management and Budget Circular No. A-109, “Major System Acquisitions,” April 5, 1976.



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retirements would begin in 2013 and continue to 2040. The KC-135 Economic Service Life Study, February 2001, concluded that, "The KC-135 fleet has an average age of approximately 41 years. The ESLS [Economic Service Life Study] does not foresee an economic catastrophe on the horizon; however, substantial cost increases are forecast and maintaining acceptable levels of availability will continue to be a struggle."

In February 2001



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The Department had explored the leasing of aircraft on several occasions before the Boeing KC-767A tanker aircraft lease. For example, on May 7, 2001, Mr. William Schneider, Jr., Chairman, Defense Science Board, at the suggestion of Mr. Steve Friedman, Chairman, National Economic Council met with finance specialists at Citicorp (New York) to brief Citicorp on DoD interest in applying commercial financing techniques to selected DoD assets, such as C-17 strategic airlift aircraft and a replacement aerial tanker for the existing fleet of 500 KC-135 tanker aircraft, and to obtain Citicorp views on statutory and regulatory obstacles that prevent the use of commercial lease finance techniques to permit DoD to finance capital asset acquisitions and the sale-leaseback of DoD real property. Subsequently, the Secretary of Defense asked Dr. Dov Zakheim, Under Secretary of Defense (Comptroller) on May 11, 2001, to initiate a process to get commercial financing techniques moving and to coordinate with the appropriate people, including the DoD Office of General Counsel.

Events of September 11, 2001, accelerated Air Force efforts to begin recapitalization of the aging KC-135 tanker aircraft fleet. On September 25, 2001, Ms. Darleen A. Druyun, Principal Deputy Assistant Secretary of the Air Force (Acquisition and Management) met with Messrs. Daniels, Albaugh, Davis, Hill, Gillis, Gower, and Lindberg at Boeing to lay out a strategy to lease 100 Boeing KC-767A tanker aircraft by building 18 to 20 aircraft per year during a 10-year lease. After the meeting, Mr. John Sams at Boeing was tasked to develop briefs on the tanker aircraft lease concept by September 26, 2001, for Mr. Daniels and Ms. Druyun to take to Capitol Hill.

On October 9, 2001, in a letter to a Representative, Dr. James G. Roche, Secretary of the Air Force expressed appreciation for the congressional interest in jump starting the replacement of the KC-135 tanker fleet. Secretary Roche stated, "I strongly endorse beginning the upgrade to this critical warfighting capability with new Boeing 767 aircraft. If Congress provides the needed supporting language, we could initiate this program through an operating lease with the option to purchase the aircraft in the future."

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In late October 2001, the Air Force began to develop an operational requirements document for the tanker tailored to Boeing KC-767A tanker aircraft capabilities even though it had not performed an analysis of alternatives to determine whether the Boeing KC-767A was the preferred solution to the tanker replacement issue.

On November 1, 2001, Mr. Aldridge and Dr. Dov S. Zakheim signed a letter that formed a leasing panel to review all proposed leases with a cost of \$250 million or more.

On November 8, 2001, according to an e-mail by Mr. John Sams at Boeing, Major General Essex, Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) met with representatives from the Congressional Budget Office to receive an out-brief of the Office's recommended scoring position on the tanker lease program, which was as a capital lease (not an operating lease). The Congressional Budget Office concluded that the program could only happen as a lease if it was handled as a capital lease.

On December 3, 2001, Mr. Rudy De Leon at Boeing sent an e-mail to senior Boeing Company executives to which he attached a report by Mr. Andrew Ellis at Boeing about Mr. Ellis' conversation with Ms. Druyun. According to the report, Ms. Druyun stated that the Senate Appropriations Committee will continue to work the issue with the Congressional Budget Office. However, the report stated that Ms. Druyun had the following comments and observations:

- Her view was that the tanker language in the Congressional Budget Office construct was not viable.
- Bottom line on Congressional Budget Office construct was extremely negative.

On December 5, 2001, Ms. Druyun sent an e-mail to Dr. James G. Roche; General John Jumper, Air Force Chief of Staff; General Robert Foglesong, Air Force Vice Chief of Staff; and Dr. Sambur in which she stated:

[A Representative] and [a congressional staffer] faxed me the new language that will go to the conference. They have fixed some of the issues but as written it is still not executable. [A Representative] called again this a.m. to get my sense of executability and this is what I said to him: The language requires the Air Force lease green [Boeing] 767 aircraft but procure through separate Auth/Approp [Authorization/Appropriation] the mod [modification] to make it a tanker. This means the aircraft cost is [REDACTED] which I then do my fair market value 90% assessment. For a ten-year lease I bust the 90% to 116% under OMB [Office of Management and Budget] Circular A-11.

b(4) - OSD Redaction

On December 5, 2001, in response to Ms. Druyun's December 5, 2001, e-mail, Dr. Sambur sent an e-mail to Dr. Roche, Ms. Druyun, General Jumper, and General Foglesong with a cc: to Mr. Willard H. Mitchell, Deputy Under Secretary of the Air Force (International Affairs) in which he stated that, "Since this email, Darleen [Druyun] has done an excellent job on the Hill to modify the language so that it [is] approaching the doable range."

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On December 12, 2001, an Office of Management and Budget official sent a letter to a Representative that stated in part:

In your letter you ask that the economic stimulus package include money for the lease or purchase of new B-767 aircraft as tankers for the Air Force. We have grave reservations about leasing these aircraft. Our analysis shows that over the long-term a lease-purchase program would be much more expensive than direct purchase of the same aircraft. With regard to the possibility of procuring the aircraft, we have now begun the programmatic and budget reviews necessary for the preparation for the FY 2003 Budget submission. In this process programs are evaluated in terms of their cost and potential military benefit. Please be assured that we will consider your request carefully as we prepare the FY 2003 Budget request.

On December 17, 2001, an e-mail from Major General Essex to Dr. Sambur stated that:

Mrs. Druyun, Boeing, and Air Staff reps meet end of last week to develop and examine set of options which meet the requirements for an operating lease. Over weekend further refined these options and began building briefing which lays out an Integrated Master Schedule combining all Boeing and Government actions required to obtain congressional approval and initiate the program. We will brief this to Mrs. Druyun Wednesday at 0700, along with the matrix of options which meet the operating lease gates. The variables in the matrix are: purchase price, lease term, interest rate, residual value, and lease payment. All the options presented will meet the OMB [Office of Management and Budget] gates.

In January 2002, Section 8159 of the Department of Defense Appropriations Act for FY 2002 stated that the Air Force may lease up to 100 Boeing commercial KC-767A tanker aircraft. The Air Force used the language in Section 8159 as direction to move the lease forward. The program for the lease of 100 aircraft was moved forward despite the fact that the Air Force had not performed an analysis of alternatives to determine the need for 100 aircraft. In fact, the studies that were available did not indicate an urgent or immediate requirement for the replacement of existing KC-135 tankers. In addition, the Air Force used Section 8159 of the Department of Defense Appropriations Act for FY 2002 to justify its inappropriate acquisition strategy with the primary goal to expeditiously lease 100 Boeing KC-767A tanker aircraft to replace its aging KC-135E Tanker fleet. In doing so, the Air Force did not demonstrate best business practices and prudent acquisition procedures in developing this program and did not comply with statutory provisions for testing.

On February 14, 2002, Ms. Druyun responded to an e-mail from Dr. Roche with a cc: to Dr. Sambur; Mr. John P. Janecek, Air Force Deputy General Counsel (Acquisition); Ms. Mary L. Walker, Air Force General Counsel; and Major General Essex. In her response, Ms. Druyun stated that:

You are right on about doing this as a prelude to a buy. I am hopeful we can smoke out the data we need to be able to look anyone in the eye and tell them why we are or are not conducting a competition. I am working with Jon Janecek...Speedy's idea is great or [sic] We will get on your calendar.

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On February 20, 2002, Brigadier General Darryl A. Scott, Deputy Assistant Secretary (Contracting), Office of the Assistant Secretary of the Air Force (Acquisition) signed out a request for information to The Boeing Company and Airbus North America, Inc. (European Aeronautic Defence and Space Company, Incorporated) to begin the Air Force's market research and assess market capabilities in the area of commercial aerial tankers.

On March 28, 2002, Dr. Sambur sent a letter to Mr. Aldridge [REDACTED]

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[REDACTED] The guidance states that, if a contracting officer is unable to obtain information on prices at which the same item or similar items have been sold in the commercial market to use for evaluating, through price analysis, the reasonableness of the price of the contract, the contracting officer may require cost or pricing data. The guidance from the Director reminds contracting professionals to include the applicable Federal Acquisition Regulation clause in solicitations for sole-source commercial items.

On July 30, 2002, the Joint Requirement Oversight Council approved the operational requirements document, which the Air Force issued on October 22, 2002. However, using the legislation as the informal acquisition strategy, Air Force officials did not tailor the first spiral or increment of the operational requirements document to warfighter requirements in the mission needs statement for future air refueling aircraft. Instead they tailored it to correlate closely with the capabilities of the Boeing 767 tanker variant that Boeing was producing for the Italian government. As a result, the first 100 Boeing KC-767A tanker aircraft will not meet the operational requirement for interoperability and will not meet the mission capabilities in the operational requirements document to conduct secondary missions, such as cargo/passenger and aeromedical evacuation missions.

On August 20, 2002, Mr. Wayne A. Schroeder, Deputy Under Secretary of Defense (Resource Planning/ Management), Office of the Under Secretary of Defense (Comptroller) sent an e-mail to Dr. Dov S. Zakheim, Under Secretary of Defense (Comptroller). In the e-mail, Mr. Schroeder stated:

Dov,

Due to some schedule conflicts and absences, [REDACTED] requested that we reschedule the 767 tanker meeting with OMB [Office of Management and Budget] to later this week or next. But I did have a chance to speak with [REDACTED] about OMB's high profile. [REDACTED] said that OMB has been responding to letters from [a Senator] (they also just received a letter on the issue from [a Representative]). So part of their public profile has to do with responding to congressional requests for their position on the issue - [a Senator] wanted to get it 'on the record.' But [REDACTED] did say that the political leadership at OMB feels very strongly

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about the lease, and has decided to take a public posture knowing the effects this might have. He suggested you talk directly with Robin [Cleveland] if you want more information on the politics of the lease at OMB. He also gave me some insights into what OMB has learned about the lease from technical questions the Air Force has posed to them:

1. The deal is looking 'worse and worse.'
2. OMB is getting a lot of Air Force questions about A-94 and lease-purchase analysis.
3. Boeing will not finance this deal. It would be financed through an investment group or special purpose company partly owned by Boeing, the engine manufacturer and other investors. The Air Force would lease the tankers from this investment group, which would issue a set of bonds at different terms and interest rates.
4. The Air Force had questions for OMB about what interest rate they can use. Predicting interest rates is problematic, and could have a major impact on the analysis. OMB thinks the Air Force will want a very low interest rate and very high discount rate to make the lease-purchase analysis work.
5. The marketability of the aircraft is an issue. The Air Force will likely propose for purposes of calculating the residual value of the aircraft, that at the end of the lease they be sold as either freighters or tankers. Not all 100 could be sold as tankers in the open market.
6. OMB thinks the Air Force could have gotten a much better deal on the purchase price than what they will show in the analysis.
7. To convince investors that this is not a risk, the Air Force will tell them that they will buy the aircraft at the end of the lease. This raises the question of why this will be structured as an operating lease, when the intent is clearly lease-to-buy. If this turns out to be the case, it will be an issue.

As we get more details, I will pass more information on to you and Larry after we hold the meeting with OMB. Rob said he thought the Air Force and Boeing might finalize negotiations toward the end of next week.

On August 20, 2002, in response to Mr. Wayne A. Schroeder's e-mail, Dr. Dov S. Zakheim sent an e-mail to Mr. Wayne A. Schroeder with a cc: to Mr. Lawrence J. Lanzillotta in which he stated that:

[T]his does seem very troubling.

On August 20, 2002, Mr. Lawrence J. Lanzillotta forwarded Mr. Wayne A. Schroeder's e-mail to Mr. John Roth, Deputy Comptroller (Program/Budget), Office of the Under Secretary of Defense (Comptroller); and Mr. Ronald G. Garant, Director, Investment, Office of the Under Secretary of Defense (Comptroller).

On August 21, 2002, in response to Mr. Wayne A. Schroeder's e-mail, Mr. Ronald G. Garant sent an e-mail to Mr. Lawrence J. Lanzillotta with a cc: to Mr. John Roth, and Mr. Wayne A. Schroeder in which he stated:

I talked to [REDACTED] a month or so ago. He was the AF [Air Force] deputy comptroller. The AF hired him to give their proposal the grandmother test and as far as he was concerned it didn't pass. He contends that the purchase price is probably over stated by 50% and he contends that the residual value is also very much overstated for a non-Air Force market. He was also concerned about the discount and interest rates used in the calculations.

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Since we all know that this is a bailout for Boeing why don't we just bite the bullet and do what we did when we were bailing Douglas out on the KC-10's. We didn't need those aircraft either, but we didn't screw the taxpayer in the process. The 767 is not the latest in technology. If we were going to get serious about buying the best I am sure that some rendition of the 777 would win out.

I don't know of anyone who is dissatisfied with the outcome of the KC-10 deal. The Air Force should be made to come back with an analysis of why we couldn't do the same with the 767. What we in effect would be buying is the tail end of the production line and should be getting the best price, not the inflated price that they want to put in the lease formula. The key of course is to include some competition into the purchase process. [Emphasis added.]

During 2002, questions began to surface concerning the unit price of the aircraft as well as cost analysis of lease versus purchase. The Air Force submitted the tanker lease acquisition business case to the Office of the Secretary of Defense Leasing Review Panel in September 2002. An independent analysis of the price of the tanker aircraft contracted for by the Leasing Review Panel and conducted by the Institute for Defense Analyses indicated that the negotiated individual Boeing KC-767A tanker aircraft price was excessive. Further, the Air Force negotiating team did not have sufficient information without Boeing cost or pricing data or complete information on Boeing prior sales to calculate an accurate price for the "green aircraft" (basic Boeing 767 aircraft). The Air Force stated "By relying on other cost and price data and techniques, a fair and reasonable price is represented by a wide range. Calculating the best price within this range must reflect the medium risks of the effort." The degree to which prices can differ is evident from the Air Force and Institute for Defense Analyses results that use a different mix of Boeing 767-200ER and 767-400ER aircraft and different preferred customer discount rates in their calculations for "green aircraft" prices. For example, the analysis by the Institute for Defense Analyses showed a [REDACTED] price differential (savings) from the Air Force negotiated price for the "green aircraft." The price differential (savings) from the analysis by the Institute for Defense Analyses would increase from [REDACTED] to [REDACTED] when using a preferred customer discount rate of 35 percent to 50 percent for a significant competitive order. The Boeing Web site showed 941 orders for Boeing 767 model aircraft to 66 different customers since 1978, or an average purchase of 14 aircraft per customer. The single largest customer, [REDACTED] procured 117 aircraft on 6 different orders from 1978 to 1997. Consequently, the Air Force order for 100 Boeing KC-767A tanker aircraft and the potential for the Air Force to order several hundred additional aircraft should have entitled the Air Force to a higher preferred customer discount rate than was included in the Air Force's negotiated price for the "green aircraft."

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In September 2002, the Air Force began to address criticism as to whether the Air Force had an urgent requirement for jump starting the recapitalization of the KC-135 tanker fleet. Justifying the urgent need, the Air Force indicated that it had discovered a significant corrosion problem that coupled with the average age of the fleet and increasing operations and maintenance costs required immediate recapitalization of the tanker fleet. However, formal studies both before and after this problem was identified in the Air Force presentations indicated that the problem was manageable and did not recommend moving the replacement date of

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the tankers as an immediate and urgent requirement. Specifically, in April 2004, the National Defense University issued a report concluding that the Air Force and the Department of Defense bypassed many elements of the normal acquisition system and that the Office of the Secretary of Defense Leasing Review Panel was not a substitute for the Defense Acquisition Board review of the tanker lease acquisition. The National Defense University also concluded that the Air Force did not use a competitive process for the tanker lease acquisition although contractor selection was a foregone conclusion based on Section 8159 of the Department of Defense Appropriations Act for FY 2002 and the Joint Requirements Oversight Council. Also, in May 2004, the Defense Science Board concluded that the KC-135 airframe would still be capable until 2040 and that the corrosion problem was manageable. The Board also commented on tanker recapitalization noting that the Air Force needed to embark on a major tanker recapitalization program, but because total tanker requirements are uncertain, the recapitalization program can be deferred until the completion of the analysis of alternatives and the Mobility Capabilities Study.

On September 11, 2002, Dr. Sambur sent an e-mail to Dr. Roche in which he stated:

Boss

I kicked off the effort to establish a 'need' justification for the tankers. Hope to have a conceptual framework ready by the end of the week. Spoke to Robin [Cleveland] after the meeting to tell her that the economic justification is not a slam dunk for either position (purchase or lease). It is more a push and a slight change in the interest rates can flip the analysis. At the end of the day, we have to prove that there is a TRUE need and that there are other advantages to leasing (earlier delivery, affordability, etc) that make it a good business deal. It is going to be a tough sell given the other factors such as liability and indemnification.

Marv

On September 20, 2002, Major General Leroy Barnidge, Air Force Director of Legislative Liaison sent an e-mail to Dr. Roche; General John Jumper, Air Force Chief of Staff; General Robert Foglesong, Air Force Vice Chief of Staff; and Lieutenant General Joseph H. Wehrle, Jr., Air Force Assistant Vice Chief of Staff. In his e-mail, Major General Leroy Barnidge stated:

Sirs -

Late yesterday, [a Representative] made a late notice visit to Andrews to see the new 737s. He was pleased with what he saw. Of note, however, he pulled [REDACTED] over (who had run to support [the Representative's visit] and related that he, [the Representative], had talked with [REDACTED] ref [Boeing] 767 lease. Said, ' [REDACTED] agreed that we need to make this work.' Also told [REDACTED] that he ([the Representative]) '....will work with SAC

b(6) - OSD Redaction

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\*The Report does not include full verbatim text of this e-mail because staff of the White House Counsel has indicated its intent to invoke an agreement between Members of Congress and the White House covering the production of tanker-related e-mails -- the inclusion of which full verbatim text in the Inspector General's independent judgment would have circumvented the agreement. (The reference is also on page 102.)

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[Senate Appropriations Committee] leadership to ensure initiative comes together.'

Additional data point: Proposed HASC [House Armed Services Committee] language is [s]till more restrictive:

'The Secretary of the AF [Air Force] shall not enter into any lease for tanker aircraft until the Secretary submits the report required by section 8159 (c) (6) of the Department of Defense Appropriations Act, 2002 and obtains authorization and appropriation of funds necessary to enter into a lease for such aircraft consistent with his publicly stated commitments to the Congress to do so.'

Dr. Roche, we will rehighlight [the Representative's] position in your email prep [preparation] before your office call with [the Representative] next Wed, 25th, 1800.

On October 7, 2002, Dr. Sambur sent an e-mail to Dr. Roche in which he stated:

[REDACTED]

b(5) - OSD Redaction

OMB concerns are all answerable, but not irrefutably so. For example, Requirements – They view our requirements chart and maintain that the delta between need and availability is bogus given that we have been able to live with the deficit for so many years (and especially during the present conflict). Our answer is that we have been playing Russian roulette.

Refund scheme. They view the scheme as very clever but violates the congressional rules and the operating lease requirements. Our answer is that we have no commitment to buy the tankers. Only an agreement to get a payback should they sell the tankers for more than \$30M [million]. Commercial lease. They view the market for tankers as only being military (which violates the operating lease rules). We assert that they may be correct but the residual value is based on the commercial use of the planes as commercial cargo transports and not as tankers. The residual value has the conversion to transport already baked into the price.

Modification of the [Boeing] 767. They argue that we have violated the congressional language that requires a green plane. We answer by pointing to the congressional dialog that defines a green tanker.

You may have to have another high level meeting (Robin [Cleveland]) to discuss these issues.

Marv

On October 22, 2002, Dr. Sambur sent an e-mail to Dr. Roche in which he stated:

Boss

Our problem is that we do not have a good answer to why we claim that we have a[n] urgent need for tankers BUT we are retiring 67 KC135E's in the FDYP [FYDP (Future Years Defense Program)] to save \$1B [billion] BUT we need an additional \$1.7B [billion] to lease the tankers.

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\*Removed for reason stated in the initial asterisked footnote. (The reference is also on page 109.)



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Our other problem is that we have a parametric approach to deriving pricing that has black magic associated with the weighing function. I tried to give an intuitive interpretation that went down better but our inability to explain in a concise manner the complicated weighing function is an issue. I am working with our people to develop a more concise explanation.  
Marv

On October 29, 2002, Mr. Andrew K. Ellis at Boeing sent an e-mail to Ms. Druyun in which he stated:

[D]arleen:

[I]nformation on tanker value/jobs [I] sent to you last night was pulled together this past summer and is very conservative. [W]hen you work through the numbers, only about 60% of the domestic value of the tanker is even identified/mapped. [I]t translates to only about [REDACTED] direct domestic jobs, when we believe, in the end, program will actually support at least [REDACTED] direct jobs. [D]ata is a fair, but only partial rough order of magnitude, representation of distribution of where the dollars/jobs will end up – it should be viewed as a very conservative 'floor.'

[B]ob [G]ower's team ran numbers last night based on projected spend plans by year. [B]ased on these spend plans, they used a very conservative factor of [REDACTED] to derive year by year cumulative employment numbers, even using this conservative factor, employment reaches [REDACTED] [U]sing a less conservative dollar/job factor would put direct tanker jobs well up over 30,000.

[F]or [W]hite [H]ouse, this shows direct tanker jobs (it will be some currently unidentifiable combination of 'creating new' or 'sustaining existing' jobs) growing rapidly from the [REDACTED] – if [W]hite [H]ouse makes decision to move forward with the program.

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[O]f course, adding indirect jobs provides a significant boost in these employment numbers.

[H]opefully the combination of approximate state by state distribution of value/jobs, and the cumulative year by year employment numbers below, will provide you enough ammunition for the [S]ecretary to respond to [W]hite [H]ouse.

[O]nce [S]ecretary responds, we can reinforce similar message through other channels.

On November 5, 2002, Ms. Druyun, who had been involved in all aspects of the Boeing tanker aircraft lease efforts to date, submitted a letter to the Air Force ethics office, recusing herself from further negotiations with Boeing; retired mid-month; and accepted an executive position with Boeing.

On November 20, 2002, Mr. William C. Bodie, Special Assistant to the Secretary of the Air Force sent an e-mail to Dr. Roche in which he stated:

Good for you, boss. [Mr.] Aldridge may deny he's been weakening, but the smoke signals are thick. Aldridge interviewed with Anne Marie [Squeo, 'The Wall Street Journal'] yesterday, and although he wouldn't comment on specifics of any deal and was keeping an open mind, he indicated that in general terms he would have concerns about leasing

when/if buying was cheaper. That doesn't jibe with his previous support for the lease from a NPV [net present value]/cash flow management perspective. In addition, the spores seem to be pushing a 'what's the rush?' line: buying is cheaper (we 'exaggerate' the purchase cost of a green [Boeing] 767), therefore better; such a large expenditure requires more 'rigorous analysis' than the back-of-the-envelope assertions by the AF [Air Force], hence an AoA [analysis of alternatives]; the AF hasn't POM'ed [program objectives memorandum] for the lease, so how serious can we be? There is no 'urgent' need because the AF is starting to retire the E's next year even without an immediate replacement, so why can't we be more deliberative? Boeing will still be there, making airplanes, so what's the rush? Anyway, Airbus could make planes with enough American content if need be. I rebutted all these arguments with Jaymie [Durnan, The Special Assistant to the Secretary and the Deputy Secretary of Defense] (as you did with Pete [Aldridge]), but we might be in the 'power' phase with OSD [Office of the Secretary of Defense] on this issue. If anyone can talk sense to Aldridge, however, it's you.

On November 20, 2002, in response to Mr. William C. Bodie's e-mail, Dr. Roche sent an e-mail to Mr. William C. Bodie in which he stated:

Right. I'm relaxed on this one. They have to take the bureaucratic position. Jim

On December 18, 2002, [REDACTED] Chief of Mobility and Special Operations Forces, Weapons Systems Liaison Division, Office of Air Force Legislative Liaison sent an e-mail to Major General Leroy Barnidge, Jr., Air Force Director of Legislative Liaison in which he stated:

b(6) - OSD Redaction

Maj Gen [Major General] Barnidge,

As you know, there has been some conversation about a possible meeting with [a Representative's] office (generated from the [Representative's] office through [congressional staff]), OSD [Office of the Secretary of Defense] and one AF [Air Force] representative. OSD/LA [Office of the Assistant Secretary of Defense (Legislative Affairs)] [REDACTED] called [congressional staff] this morning to determine the [Representative's] desire for the meeting.

b(6) - OSD Redaction

[REDACTED] This eliminates the need for a meeting in which the AF, OSD, and the [Representative's] office were going to talk about the need for tankers right now, [Boeing] 767 ability to fill this need, and the 767 acquisition strategy.

b(5) - OSD Redaction

Way Forward: Where we are at right now is that OSD at the highest levels is getting together (DepSecDef [Deputy Secretary of Defense], Mr. Aldridge, Dr. Zakheim, Powell Moore [Assistant Secretary of Defense (Legislative Affairs)], etc) to decide the DoD way forward. The decision will be to support the lease now or show why decision should wait until a later time. I am not sure when the meeting will occur, but waiting until March (the date previously given by OSD) is no longer an option. According to [REDACTED] this will be decided soon and it is more now an issue of OSD explaining why DoD shouldn't do the lease then [sic] it is the AF explaining why we should (a reversal of the normal process). I will keep you posted.

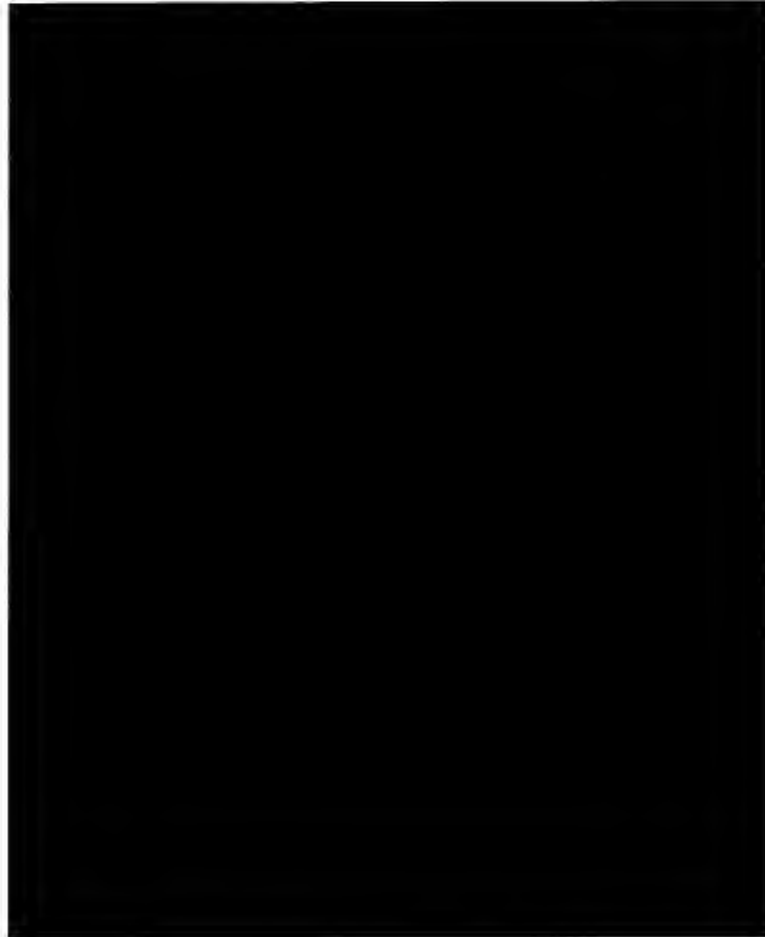
b(6) - OSD Redaction

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\*Removed for reason stated in the initial asterisked footnote. (The reference is also on pages 117 and 185.)

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On January 30, 2003, General John Jumper, Air Force Chief of Staff sent an e-mail to Dr. Roche in which he stated:



b(5) - OSD Redaction

On January 31, 2003, in response to General John Jumper's e-mail, Dr. Roche sent an e-mail to General Jumper in which he stated:

And, I had at Himself on the deal in the morning, noting as I poin[t]ed to them that, unlike businessmen who would understand how good an opportunity this was, these Corporate Staff bureaucrats (Dov and Stevie) can't get it. Don asked if I was special pleading. I said 'yes.' And, further, would continue to do so. [Lawrence] DiRita [Principal Deputy Assistant Secretary of Defense (Public Affairs)] announced that my comments 'were brought to you by the Boeing Company.' I didn't rip his heart out. Don had been programmed by the Tall Spore and asked about 'opportunity costs', etc to which the Spores jumped. But, when asked what was in the budget, I had the chance to take a shot at the TS [Tall Spore] by telling Don that we wouldn't beartrap [sic] him by assuming that he approved the lease; thus, the budget had a buy. Pete

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\*Removed for reason stated in the initial asterisked footnote. (The reference is also on pages 120, 188, and 210.)

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then told him the 'when' of the buy, and Don said: 'Not soon enough!' Through the day, I have been asked by the Spores to consider a lease of 50 with an option for 50, and a 67/33 split. Each time I remind them that these hairbrained [sic] ideas would only be more expensive. Don asked that the decision be delayed until after he testified!!! Note: he doesn't want to touch it. But, there is no doubt that he understands our position.

b(5) - OSD Redaction

In February 2003, Dr. Sambur sent a memorandum to senior DoD management arguing for the lease rather than procurement of the Boeing KC-767A tanker aircraft even though the Air Force had not conducted an analysis of alternatives to justify the lease, had not justified an urgent need for the Boeing KC-767A tanker aircraft based on previous studies, and had not shown how leasing instead of purchasing the aircraft was a prudent expenditure of taxpayer money.

As previously stated, the Air Force, at the direction of Mr. Aldridge, did not follow the procedures for a major Defense acquisition program. Further, the proposal that started to move forward was improperly identified as an operating lease which meant that it would be funded in current year Operation and Maintenance funds versus the multiyear procurement funds. In addition, the Air Force improperly identified the Boeing KC-767A tanker aircraft as a commercial item subject to the rules of the Federal Acquisition Regulation, Part 12, "Acquisition of Commercial Items," rather than Federal Acquisition Regulation, Part 15, "Contracting by Negotiation," to meet Office of Management and Budget requirements for leasing the aircraft rather than procuring the aircraft. As a result of this improper designation, the Government forfeited the ability to obtain cost and pricing data. The Air Force determination was improper because the Boeing KC-767A Tanker Program did not meet the statutory definition of a commercial item. No commercial market for this tanker aircraft existed to establish reasonable prices by the forces of supply and demand. Consequently, the commercial item procurement strategy did not provide the Air Force with sufficient cost or pricing data to make multi-billion dollar decisions for the Boeing KC-767A Tanker Program and did not demonstrate the level of accountability needed to conclude that the prices negotiated represented a fair expenditure of DoD funds.

In March 2003, the issue concerning price was raised again by the Under Secretary of Defense (Comptroller). The underlying issue with the price was that the Air Force improperly determined that the tanker aircraft was a commercial item, thereby preventing the Government from having the rights to Boeing's cost and pricing data. Without a competitive market place and the inability to obtain cost and pricing data, the Air Force was unable to determine whether the Boeing offering price was fair for the aircraft as modified into a tanker configuration. The Comptroller also recommended that the acquisition be properly classified and declared a major Defense acquisition program (Acquisition Category I). Also in March 2003, the Secretary of Defense met with senior Office of the Secretary of Defense and Air Force officials to consider the status of the Office of the Secretary of Defense assessment of the Air Force Boeing KC-767A tanker lease

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\*Removed for reason stated in the initial asterisked footnote. (The reference is also on page 121.)

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proposal and to make a decision on whether to accept the tanker lease proposal or to request multiyear procurement authorization to purchase the tanker aircraft.

On April 7, 2003, Mr. Andrew K. Ellis at Boeing sent an e-mail to Mr. Jim Albaugh at Boeing, stating that the Deputy Secretary and the Under Secretary of Defense for Acquisition, Technology, and Logistics were to interface with the officials from the White House and the Office of Management and Budget to move the tanker aircraft lease forward and to change the focus of the lease from 100 to 200 aircraft. The e-mail stated that the Secretary of Defense told the Under Secretary of Defense for Acquisition, Technology, and Logistics to finalize the deal.

On April 10, 2003, Mr. Jim Albaugh at Boeing sent an e-mail to Mr. Phillip M. Condit at Boeing in which he stated:

Phil, we had a curve thrown at us today by Mike Wynne [Principal Deputy Under Secretary of Defense for Acquisition, Technology, and Logistics]. Mike asked the AF [Air Force] for a \$100M [million] tanker. The AF is livid with this. At a \$100M they get minimal capabilities and an airplane that cannot be financed since it is not a freighter. I have talked to both [Drs.] Sambur and Roche today and armed them with a descoped \$139.5M version which they like and info on why any option at a lower price doesn't work.

We don't think Pete Aldridge is on board with what Mike [Wynne] is asking for. Pete was out of the office today. Expect to talk to him tomorrow.

The saga continues.

On April 15, 2003, Mr. Wynne sent an e-mail to senior DoD executives detailing his efforts to reconcile the Institute for Defense Analyses values with the Boeing Company values by resetting the baseline to achieve a price reduction. Mr. Wynne concluded:

This will not be easy, given the long history on this deal, and the consequences of a sudden change of heart. I would have expected that the concessions should have and could have come as a result of configuration changes which would have provided some cover for both teams. Recall, I gave them that opportunity over the past two weeks. In that absence...

We should afford Boeing this last opportunity, and then call it a day for the lease.

On May 3, 2003, Mr. Paul Weaver, a consultant to Boeing sent an e-mail to Dr. Roche in which he stated:

Sir,

I just got off the phone on a conference call with Jim [Albaugh] and Rudy [De Leon]. They got your message, loud and clear. Jim is putting together a proposal, with guarantees that I think you will like. They will conference again this afternoon with the final numbers and then Jim will give you a call with a proposal.

On May 9, 2003, Dr. Roche sent an e-mail to Ms. Robin Cleveland, Director, Office of Management and Budget, the subject of which was Peter Cleveland resume and cover letter attached for export. In the e-mail, Dr. Roche stated:

Be well. Smile. Give tankers now (Oops, did I say that? My new deal is terrific.) ☺  
Jim

On May 23, 2003, Mr. Aldridge signed the "Air Force Boeing 767 Tanker Lease Decision Memorandum" approving the Air Force request to lease 100 Boeing KC-767A tanker aircraft before:

- the Office of the Secretary of Defense Leasing Panel finalized its review or made a recommendation concerning the viability of the lease;
- the Air Force conducted an analysis of alternatives and developed an acquisition strategy and an independent cost estimate; and
- the Defense Acquisition Board conducted a review of the lease.

Further, the May 23, 2003, "Air Force Boeing 767 Tanker Lease Decision Memorandum" stated that "The Secretary of Defense approved this lease proposal contingent upon securing a waiver of the requirement to fund termination liability and approval of the Office of Management and Budget."

On May 27, 2003, Mr. Aldridge resigned as Under Secretary of Defense for Acquisition, Technology, and Logistics and Mr. Wynne was appointed as the Acting Under Secretary Defense for Acquisition, Technology, and Logistics.

On May 28, 2003, Mr. Wynne forwarded the Acquisition Decision Memorandum to the Office of Management and Budget detailing the intent to move forward with the proposed operating lease.

On June 20, 2003, Mr. Kenneth J. Krieg, Director, Program Analysis and Evaluation issued a memorandum stating that purchase was more cost effective than leasing the Boeing KC-767A tanker aircraft. In addition, he stated in the memorandum that the lease as proposed did not meet the requirements of Office of Management and Budget Circular No. A-11, "Preparation, Submission, and Execution of the Budget (2003)."

On June 23, 2003, according to Boeing executives in an e-mail, Dr. Roche requested, in a meeting with them, that Boeing put pressure on Mr. Wynne to have Mr. Krieg change his position on the Boeing KC-767A tanker aircraft lease.

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\*Removed for reason stated in the initial asterisked footnote. (The reference is also on page 127.)

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On July 8, 2003, Dr. Roche sent an e-mail to Mr. Jaymie Durnan, The Special Assistant to the Secretary and the Deputy Secretary of Defense in which he stated:

Jaymie, Mike Wynne has fallen for [Robin] Cleveland's line that our letter must show the bogus calculation which is NPV [net present value] negative by \$1.9 billion.

Why bogus? If we had the budget, we wouldn't need to turn to a lease. But, we don't. Thus, to assume that it exists (wrong premise), and then to assume the Congress passed legislation which it didn't, and then to condemn ourselves in writing by stating the calculation based on a fantasy simply is crazy. It is a bureaucratic trick to make a fool out of Don [Rumsfeld] as well as the Air Force. All this was 'resolved' by Pete Aldridge before he left. To quote him: 'We need to go forward with DoD's position. If OMB [Office of Management and Budget] wants to comment, let them.'

Point: we are running aground because PA&E [Program Analysis and Evaluation] and OMB want me to sign a suicide note, BUT I WILL NOT. This whole drill has gotten our of hand! Jim.

On July 22, 2003, the Acting Under Secretary of Defense for Acquisition, Technology, and Logistics requested that the Department of Defense Office of the Inspector General:

- review the decision process used by the Air Force and the Office of the Secretary of Defense to lease the Boeing KC-767A tanker aircraft, and
- assess whether DoD interaction with Congress following the "Air Force Boeing 767 Tanker Lease Decision Memorandum," May 23, 2003, was timely and reasonable.

On August 20, 2003, the Secretary of the Air Force halts the performance of an analysis of alternatives for the tanker aircraft pending the direction of the Authorization Bill.

On August 29, 2003, in response to the July 22 request by the Acting Under Secretary of Defense for Acquisition, Technology, and Logistics, we issued Department of Defense Office of the Inspector General Report No. D-2003-129, "Assessment of DoD Leasing Actions." The report states that, although not required by statute, applying a best business practice of weighing the need to conduct a formal analysis of alternatives to achieve the best possible system solution could have improved the Air Force Leasing process. Further, a best business practice would have been to expand the charter of the Office of the Secretary of Defense Leasing Review Panel to include the Panel's role in the acquisition process and in the life cycles of the leases. We also determined that of the six letters from the Chairman, Committee on Commerce, Science, and Transportation and the one letter from the Congressional Budget Office, five were generally timely and two were not timely. Further, two responses could have been improved by a more comprehensive answer to portions of the requests. However, we did not identify a reason to not proceed with the lease of the Boeing KC-767A tanker aircraft based on the limited scope of our review.

On November 24, 2003, in Section 135 of the National Defense Authorization Act for FY 2004, Congress limited the number of tanker aircraft that the Air Force could lease to 20 and authorized procurement of up to 80 aircraft. In addition,

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Section 135 of the National Defense Authorization Act for FY 2004 required that the Secretary of Defense perform a study of long-term aircraft maintenance and requirements.

On December 1, 2003, the Deputy Secretary of Defense requested an audit by the Department of Defense Office of the Inspector General, stating that "In light of recent revelations by The Boeing Company concerning apparent improprieties by two of the company's executives, please determine whether there is any compelling reason why the Department of the Air Force should not proceed with its Tanker Lease Program. In particular, I would appreciate knowing whether any of these revelations affect any of your previous analysis of this program."

On February 1, 2004, the Deputy Secretary of Defense requested that the Defense Science Board evaluate aerial refueling requirements and that the National Defense University conduct a comprehensive analysis of lessons learned for the Air Force Tanker Lease Program.

On February 24, 2004, Mr. Wynne sent a memorandum, "Analysis of Alternatives (AoA) Guidance for KC-135 Recapitalization," to the Secretary of the Air Force. In the memorandum, Mr. Wynne directed the Secretary of the Air Force to conduct an analysis of alternatives for analyzing potential courses of action for recapitalizing the KC-135 fleet, under the oversight of a Senior Steering Group.

On March 29, 2004, the Department of Defense Office of the Inspector General issued Report No. D-2004-064, "Acquisition of the Boeing KC-767A Tanker Aircraft," stating that the Air Force used an inappropriate procurement strategy and demonstrated neither best business practices nor prudent acquisition procedures to provide sufficient accountability for the expenditure of \$23.5 billion for the Boeing KC-767A Tanker Program. The report identified five statutory provisions that had not yet been satisfied relating to: commercial items; testing (two statutes); cost-plus-a-percentage-of-cost system of contracting; and leases. Therefore, the report recommended that DoD not proceed with the program until it resolved the issues pertaining to the procurement strategy, acquisition procedures, and statutory requirements.

On April 20, 2004, the National Defense University issued its report in response to the Deputy Secretary of Defense tasking on February 1, 2004. The National Defense University was tasked to answer six questions dealing with the tanker lease acquisition. Based on interviews and literature reviews, the National Defense University concluded that the:

- Air Force and the Department of Defense bypassed many elements of the normal acquisition system;
- Office of the Secretary of Defense Leasing Review Panel was not a substitute for the Defense Acquisition Board review of the tanker lease acquisition; and
- Air Force did not use a competitive process for the tanker lease acquisition although contractor selection was a foregone conclusion



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based on Section 8159 of the Department of Defense Appropriations Act for FY 2002 and the Joint Requirements Oversight Council.

The National Defense University made several recommendations to include that the Department of Defense publish guidance on leasing in policy directives, the Federal Acquisition Regulation, and the Defense Federal Acquisition Regulation Supplement; and that the Department establish procedures to require both cost and pricing data on sole source or monopoly, commercial leases.

In May 2004, the Defense Science Board issued its report in response to the Deputy Secretary of Defense tasking on February 1, 2004. The Aerial Refueling Defense Science Board Task Force reviewed the KC-135 program and concluded that, based on fatigue life, the KC-135 airframe would be capable to 2040 and that corrosion was manageable. With regard to KC-135 operation and support costs, the Defense Science Board concluded that cost growth was manageable. The Board also commented on tanker recapitalization, noting that the Air Force needed to embark on a major tanker recapitalization program, but because total tanker requirements were uncertain, the recapitalization program could be deferred until the analysis of alternatives and the Mobility Capabilities Study are completed. The Defense Science Board did not endorse the Boeing KC-767A tanker aircraft as the only Air Force near-term solution to the tanker recapitalization problem. The Defense Science Board suggested several options for replacing the KC-135Es including:

- obtaining additional DC-10s that could be converted into tankers,
- retiring half of the KC-135Es under a hybrid recapitalization program and replacing them with commercial entities as commercial tankers for missions in the Continental United States,
- phasing out the other half of the KC-135E and replacing them with converted KC-10, and
- working with major airframe manufacturers to develop new tanker options with more modern airframes than the 20-year-old Boeing 767 design.

On October 28, 2004, in Section 133 of the “Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005,” Congress terminated the authority of the Secretary of the Air Force to lease tanker aircraft; however, it authorized the Secretary to procure up to 100 tanker aircraft.

In summary, Office of the Secretary of Defense and Air Force senior officials allowed the proposed tanker aircraft lease to move forward even though the Boeing KC-767A Tanker Program had not undergone the rigid oversight required by DoD Directive 5000.1 for major acquisitions. As a result, the program was not subject to the benefits of full and open competition, an analysis of alternatives to determine the most cost effective manner to satisfy the operational deficiency, and a proper identification of the urgency and optimal number of assets needed to satisfy the requirement. There were many external influences that helped move this program along. However, the decision by the Under Secretary of Defense for Acquisition, Technology, and Logistics not to implement the requirements of

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DoD Directive 5000.1 was the major failure associated with managing and making decisions on the program. The failure to follow the prescribed acquisition rules resulted in the attempt by the Office of the Secretary of Defense and the Air Force to enter into a \$23 billion program that did not satisfy validated requirements and was not cost effective for the American taxpayer.

## **Internal Control**

DoD acquisitions are required to follow the requirements for analysis and oversight in DoD Directive 5000.1, "The Defense Acquisition System," May 12, 2003, and prior versions. The oversight mechanisms provide internal control to ensure that weapon systems acquired by DoD satisfy the needs of the warfighter and are acquired economically and efficiently using best business practices. Air Force and other DoD Acquisition Officials did not follow the proscribed procedures in DoD Directive 5000.1 for the tanker program. Instead, the Air Force used Section 8159 of the Department of Defense Appropriations Act for FY 2002 to justify an informal acquisition strategy.

**Required Documentation for Program Milestone Reviews.** DoD Instruction 5000.2, "Operation of the Defense Acquisition System," May 12, 2003, requires that the following documentation requirements be completed and reviewed by the Defense Acquisition Board at program initiation:

- Initial Capabilities Document
- Analysis of Alternatives
- Capability Development Document
- Affordability Assessment
- Acquisition Strategy
- Independent Cost Estimate and Manpower Estimate
- Acquisition Program Baseline
- Information Support Plan
- Test and Evaluation Master Plan
- Exit Criteria

For the DoD decision to acquire 100 Boeing KC-767A tanker aircraft (which could be considered a low-rate [Milestone C] or full-rate production decision), DoD Instruction 5000.2 requires that the following documentation be completed and reviewed by the Defense Acquisition Board before making those decisions:

- Capability Production Document
- Analysis of Alternatives (updated as necessary)
- Affordability Assessment
- Acquisition Strategy

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- Independent Cost Estimate and Manpower Estimate
  - Acquisition Program Baseline (updated as necessary)
  - Information Support Plan
  - Operational Test Agency Report
  - Exit Criteria

**Importance of Required Program Documentation.** The above program documentation is required and prepared for milestone decision authorities for the following purposes:

**Capabilities Documents.** The initial capabilities document establishes the need for a material approach to resolve a specific capability gap derived from the Joint Capabilities Integration and Development System analysis process. The initial capabilities document proposes the recommended material approach(s) based on analysis of the relative cost, efficacy, sustainability, and risks posed by the material approach(es) under consideration. The analysis that supports the initial capabilities document helps to shape and to provide input into the analysis of alternatives. The capability development document provides the operational performance attributes, including supportability, that the acquisition community needs to design the proposed system, including key performance parameters that guide the development, demonstration, and testing of the current increment. The capability production document addresses the production attributes and quantities specific to a single increment of an acquisition program. The program sponsor prepares the initial capabilities document, the capability development document, and the capability production document, and the Joint Requirements Oversight Council is responsible for validating the key performance parameters in the capabilities documents and then approving the documents.

**Analysis of Alternatives.** The focus of the analysis of alternatives is to refine the selected concept documented in the approved initial capabilities document. The purpose of the analysis of alternatives is to assess the critical technologies associated with the selected concept, including technology maturity and technical risks. In accomplishing the analysis of alternatives, innovation and competition should be emphasized to achieve the best possible system solution. An independent analysis activity is to prepare the analysis of alternatives and the responsible DoD Component Head designates the approval authority.

**Affordability Assessment.** The program office is required to assess system affordability at each milestone decision point beginning with program initiation. Milestone decision authorities are not to approve a program to proceed beyond program initiation unless sufficient resources, including manpower, are programmed in the most recently approved Future Years Defense Program, or will be programmed in the next Program Objective Memorandum, Budget Estimate Submission, or President's Budget. The Office of the Secretary of Defense Cost Analysis Improvement Group reviews the accuracy of cost data used in affordability assessments presented at milestone decisions for major Defense acquisition programs.

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**Acquisition Strategy.** Program managers are required to prepare and the milestone decision authority is to approve an acquisition strategy at program initiation. The acquisition strategy guides a program during system development and demonstration and includes a technology development strategy for the next technology spiral. To meet the tenets of Office and Management Circular No. A-109, "Major Systems Acquisition," and best practices of acquisition management principles, the acquisition strategy should include:

- a viable acquisition approach to rapidly deliver to the warfighter an affordable, sustainable capability that meets their expectations and adequate consideration for best business practices, applicable laws, and prudent acquisition procedures;
- a discussion of development, production, life-cycle support and costs, and test evaluation activities that provide teaming among the warfighters, developers, acquirers, engineers, testers, budgeters, and sustainers;
- program risk management to mitigate the risk and not simply accept it; and
- life-cycle sustainment of the acquisition program, including subsequent spiral development.

**Independent Cost Estimate and Manpower Estimate.** Program managers are required to prepare a life-cycle cost estimate in support of program initiation and all subsequent program milestone reviews, including full-rate production decisions. For major Defense acquisition programs, the milestone decision authority may not approve those program decisions unless an independent estimate of the full life-cycle cost of the program and a manpower estimate for the program have been completed and considered by the milestone decision authority (Section 2434 of title 10, United States Code, "Independent cost estimates; operational manpower requirements"). In addition, the Office of the Secretary of Defense Cost and Analysis Improvement Group is required to prepare an independent life-cycle cost estimate for the program and to submit a report to the milestone decision authority at all milestone reviews for all major Defense acquisition programs.

**Acquisition Program Baseline.** The program manager, in coordination with the user, is required to prepare an acquisition program baseline at program initiation and at each subsequent major milestone decision. The acquisition program baseline documents the program's approved cost, schedule, and performance objectives and thresholds. The Program Executive Officer and the Component Acquisition Executive are required to concur with the acquisition program baseline prepared by the program manager, and the milestone decision authority is responsible for approving the document at milestone decision reviews. An approved acquisition program baseline satisfies requirements in Section 2435 of Title 10, United States Code, "Baseline description."

**Information Support Plan.** Program managers are required to prepare an information support plan to identify the capabilities that information technology and national security systems require or the information needed to meet the

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proposed capability. Those capabilities need to be identified to enable the program manager to plan and manage system interoperability, interface, and infrastructure requirements before award of program contracts. The program manager submits the information support plan to the Director for Command, Control, Communications, and Computers Systems Directorate (J-6) who certifies that the information support plan addresses information requirements adequately and identifies dependencies and interface requirements among DoD acquisition programs. The milestone decision authority is required to review the certified information support plan at program initiation and subsequent milestone reviews.

**Operational Test Agency Report.** Program managers are required to prepare a test and evaluation master plan for Under Secretary of Defense for Acquisition, Technology, and Logistics and Director, Operational Test and Evaluation approval before program initiation and subsequent program milestone reviews. The test and evaluation master plan is to describe planned developmental, operational, and live-fire testing; an integrated test schedule; and the resource requirements to accomplish the planned testing. Section 2366 of Title 10, United States Codes, "Major systems and munitions programs: survivability testing and lethality testing required before full-scale production," states that a covered system, one that is being overseen by the Office of the Director, Operational Test and Evaluation, may not proceed beyond low-rate initial production (low-rate initial production is normally 10 percent of the total production quantity documented in the acquisition strategy) until realistic survivability testing of the system is completed and any design deficiency identified by the testing is corrected. Section 2399 of Title 10, United States Code, "Operational test and evaluation of defense acquisition programs," states that a major Defense acquisition program may not proceed beyond low-rate initial production until initial operational test and evaluation of the program is completed. It further states that a final decision within the Department of Defense to proceed beyond low-rate initial production may not be made until the Director, Operational Test and Evaluation has submitted to the Secretary of Defense the Director's report on the adequacy of the test and evaluation completed and the effectiveness and suitability of the program.

**Exit Criteria.** At each milestone review, beginning at program initiation, the program manager is required to propose exit criteria appropriate to the next phase of the program. The milestone decision authority approves the exit criteria. The exit criteria selected to track progress in important technical, schedule, and management risk areas serve as gates that, when successfully passed, demonstrate that the program is on track to achieve its final program goals and should be allowed to continue into the next acquisition phase.

**Complying with DoD Directive.** The KC-767A System Program Office has not developed and documented an acquisition strategy that serves as a disciplined process for acquiring a quality product that satisfies the warfighter needs at a fair and reasonable price. Instead, the KC-767A System Program Office<sup>3</sup> used Section 8159 of the Department of Defense Appropriations Act for FY 2002 to

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<sup>3</sup>Program officials stated that although the KC-767A System Program Office reports through the program executive officer structure, it is technically not a program office because it is a pre-major Defense acquisition program.

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justify its inappropriate acquisition strategy, the focus and goal of which was to expeditiously lease 100 Boeing KC-767A tanker aircraft without adequate consideration of best business practices, prudent acquisition procedures, and compliance with statutory provisions for testing.

The Air Force did not apply prudent acquisition procedures because according to Dr. Sambur, Assistant Secretary of the Air Force (Acquisition), Mr. Aldridge, Under Secretary of Defense for Acquisition, Logistics, and Technology, in November 2001, told him that the requirements of DoD Directive 5000.1 did not need to be implemented for the Boeing KC-767A tanker aircraft lease. However, neither the Office of the Under Secretary of Defense for Acquisition, Logistics, and Technology nor the Office of the Assistant Secretary of the Air Force (Acquisition) had documentation showing that the Deputy Secretary of Defense had approved the Under Secretary of Defense for Acquisition, Logistics, and Technology waiving the DoD Directive 5000.1 requirements for the Boeing KC-767A tanker aircraft lease. In our interview of the Deputy Secretary of Defense, he stated that documents you would expect to see or have approved were never prepared or staffed with anybody for the leasing decision. As a result, the Air Force did not perform many of the required oversight reviews, analyses, and acquisition planning processes normally performed on acquisitions of this magnitude.

## **Operational Requirements**

**Developing an Operational Requirements Document.** In late October 2001, the Air Force began to develop an operational requirements document for the tanker aircraft tailored to Boeing KC-767A tanker aircraft capabilities even though it had not performed an analysis of alternatives to determine whether the Boeing KC-767A tanker aircraft was the preferred solution to the tanker aircraft issue. On July 30, 2002, the Joint Requirement Oversight Council approved the operational requirements document, which the Air Force issued on October 22, 2002.

**Meeting Requirements.** Although the operational requirements document, "Air Refueling Aircraft Program," October 22, 2002, for the tanker aircraft incorporated the warfighter requirements from the Mission Needs Statement, "Future Air Refueling Aircraft," November 1, 2001, it did not require that the first 100 Boeing KC-767A tanker aircraft acquired meet those requirements. Specifically, the Air Force planned to address the requirements through evolutionary acquisition in three spirals. However, for the first 100 Boeing KC-767A tanker aircraft acquired, the Air Force only included 6 of the 7 key performance parameters in the operational requirements document and did not include the key performance parameter for information exchange requirements, which was a spiral-one requirement in the operational requirements document. Further, the Air Force has no plans to incorporate 12 of the 48 spiral-two and all 17 of the spiral-three capabilities into the first 100 aircraft. By not including the key performance parameter for information exchange requirements in spiral one, the Air Force may not achieve the objectives of the remaining key performance parameters because of their dependency on interoperability capabilities.

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## Office of the Secretary of Defense Leasing Review Panel

**Establishing the Leasing Review Panel.** On November 1, 2001, Mr. Aldridge, Under Secretary of Defense for Acquisition, Technology, and Logistics and Dr. Dov S. Zakheim, Under Secretary of Defense (Comptroller) established the Leasing Review Panel (the Panel), which they co-chaired. The Panel was responsible for reviewing all lease proposals costing \$250 million or more; however, the Panel was subordinate to the Defense Acquisition Board and its review activities with the Defense Acquisition Executive having decision-making authority on programmatic and contractual issues related to leasing proposals offered as alternatives to acquisitions of potential major Defense acquisition programs. In instances when leasing proposals were being considered as alternatives to potential major Defense acquisition programs, the Panel was to make recommendations to the Defense Acquisition Executive concerning the financial efficacy of the proposed lease. The Panel was established for the FY 2003 budget cycle; however, its continuation is subject to approval by the Secretary of Defense.

**Completing Review and Providing Recommendations.** Although required to do so, the Office of the Secretary of Defense Leasing Review Panel did not complete its review or provide recommendations concerning the Boeing KC-767A tanker aircraft lease to the Defense Acquisition Board. Accordingly, on May 23, 2003, when the Under Secretary of Defense for Acquisition, Technology, and Logistics signed the memorandum, "Air Force Boeing 767 Tanker Lease Decision Memorandum," approving the Air Force decision to lease the 100 Boeing KC-767A tanker aircraft, he did so without the Panel making a recommendation concerning the viability of the lease. He thereby circumvented the primary objective of Defense acquisition process to acquire quality products that satisfy user needs with measurable improvements to mission capability and operational support, in a timely manner, and at a fair and reasonable price.

Further, Mr. Aldridge stated in his "Air Force Boeing 767 Tanker Lease Decision Memorandum" that, "After a comprehensive and deliberative review by the Leasing Review Panel, the Secretary of Defense has approved the Air Force's proposal to enter into a multiyear Pilot Program for leasing general purpose Boeing 767 aircraft under the authority in section 8159 of the Department of Defense Appropriations Act, 2002." However, he made the decision to lease the Boeing KC-767A tanker aircraft without the Air Force completing the following:

- Independent Cost Estimate and Manpower Estimate
- Acquisition Program Baseline
- Information Support Plan
- Testing Requirements
- Exit Criteria

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## Operating Leases

Senior members of the Administration, Congress, DoD, and the Air Force worked together in an effort to use commercial financing, an operating lease, to start recapitalizing the Air Force aerial tanker fleet with Boeing KC-767A tanker aircraft. The purpose of the operating lease was to preserve budget authority for other higher priority items because the Air Force did not have money in the budget to purchase tanker aircraft.

Although senior Air Force officials consistently argued that the Boeing KC-767A tanker aircraft lease met the Office of Management and Budget criteria for an operating lease, the Office of Management and Budget, the Congressional Budget Office, the DoD Office of Program Analysis and Evaluation, and other Air Force officials had different opinions as to whether the Boeing KC-767A tanker aircraft lease should be considered an operating lease. Some of the actions that the Air Force took to “make the lease fit” were highly questionable, such as:

- paying 90 percent of the tanker aircraft’s fair market value over 6 years for a 25-to 40-year asset,
- selling the tanker aircraft at fair market value and then receiving a refund for the difference between the fair market value and the remaining 10 percent value after 6 years,
- waiving termination liability for the lease peaking at over [REDACTED] and
- using a multiyear aircraft lease price and a non-multiyear buy price for the net present value analysis.

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Congressional budget committees, the Office of Management and Budget, and the Congressional Budget Office have historically had concerns with various financing schemes involving lease-purchase arrangements because they understate the cost of capital acquisitions in the budget. When Government officials do not appropriately score lease-purchases in the budget, managers may be encouraged to purchase assets that are lower priority and that could not otherwise compete in the budget process.

See Appendix E for the complete discussion of the operating lease for the Boeing KC-767A Tanker Program.

## Commercial Item Procurement Strategy – Pricing Issues

In order to use an operating lease to recapitalize the Air Force KC-135 tanker fleet, the Boeing KC-767A tanker aircraft had to be a commercial item. Department of Defense Office of the Inspector General Report No. D-2004-064 states that “contrary to the Air Force interpretation, the military tanker aircraft is not a commercial item as defined in Section 403 of title 41, United States Code. Further, there is no commercial market to establish reasonable prices by the forces of supply and demand.”



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Throughout the negotiation process, Boeing maintained a hard line commercial pricing strategy and provided virtually no transparency into the costs of the basic Boeing 767 aircraft, tanker development and modification costs, and logistics support costs totaling almost \$25 billion for the first 100 Boeing KC-767A tanker aircraft. Boeing also failed to provide any information on prices at which the same or similar items (Boeing 767 aircraft) had been sold in the commercial market and refused to accept any type of cost reimbursable contract for the tanker development and modification costs. This lack of insight into commercial prices for 767 aircraft and cost data to support development, modification, and contract logistics support costs plagued the negotiation process and placed the Air Force at a disadvantage during the negotiation process. Again, similar to the operating lease analysis, senior member of the Office of the Assistant Secretary of the Air Force (Acquisition) consistently reported that the Air Force was getting a fair and reasonable price for the Boeing KC-767A tanker aircraft; however, the Office of Management and Budget, the Institute for Defense Analyses, and the Department of Defense Office of the Inspector General did not agree.

Several of the most serious issues identified with obtaining a fair and reasonable price include:

- Improper influence by Ms. Druyun to increase tanker modifications prices and the failure by other senior Air Force officials to support the Air Force negotiator/cost price analyst on June 17, 2002;
- Incorrect statements made by Senior Air Force officials [originating from Ms. Druyun, October 26, 2002] relating to the discount on the “green aircraft” made to [REDACTED] the Office of b(5) - OSD Redaction Management and Budget, and the Office of the Secretary of Defense Leasing Review Panel about the Air Force receiving a 7 percent better discount than a preferred airline customer;
- Questionable statements from Boeing on whether the Air Force was getting a better or equal deal than a major airline;
- Continuous “battle of BOE’s [Basis of Estimate] among the White House, the Office of Management and Budget, the Office of the Secretary of Defense, and the Air Force as a result of the commercial pricing strategy.

See Appendix F for the complete discussion of the commercial item procurement strategy and pricing issues associated with the Boeing KC-767A Tanker Program.

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\*Removed for reason stated in the initial asterisked footnote. (The reference is also on page 202.)

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## Part II – Who Was Accountable?

The following are findings and analyses derived from interviews with members of the Office of the Secretary of Defense and the Department of the Air Force, both military and civilian, including the then-Secretary of the Air Force and the then-Assistant Secretary of the Air Force (Acquisition), to gain insight into what happened and who was accountable during the structuring and negotiating of the proposed lease contract for the Boeing KC-767A Tanker Program. See Appendix D for a list of the members of the Office of the Secretary of Defense and the Air Force who were interviewed.

### Using Best Practices and Acquisition Procedures

**Who within DoD and the Air Force was responsible for making decisions not to use best practices and acquisition procedures in planning to lease the Boeing KC-767A tanker aircraft?**

#### Issue

Office of the Secretary of Defense and Air Force acquisition management officials did not manage the Boeing KC-767A Tanker Program consistent with statute and regulatory requirements. Specifically, DoD Instruction 5000.2 documentation and review requirements that are mandatory at program initiation and before a low-rate or full-rate production decision were not enforced. Additionally, the Defense Acquisition Executive made the decision on May 23, 2003, to lease 100 Boeing KC-767A tanker aircraft without review by the Defense Acquisition Board or the completion of the review by the Office of the Secretary of Defense Leasing Review Panel. In addition, after the last Leasing Review Panel meeting held before the leasing decision, Mr. Wayne Schroeder, who represented the Under Secretary of Defense (Comptroller/Chief Financial Officer) as co-chair of the Leasing Review Panel, advised the Under Secretary of Defense (Comptroller/Chief Financial Officer) in a memorandum that he recommended that DoD should not proceed with the lease and that instead DoD should procure the tanker aircraft by multiyear procurement.

#### Policy

DoD Directive 5000.1, "The Defense Acquisition System," May 12, 2003; DoD Instruction 5000.2, "Operation of the Defense Acquisition System," May 12, 2003; and Air Force Instruction 63-101, "Acquisition System," May 11, 2004, establish management principles that are applicable to all DoD, including Air Force, acquisition programs. Jointly, the Under Secretaries of Defense for Acquisition, Technology, and Logistics and Comptroller/Chief Financial Officer issued a memorandum for the Office of the Secretary of Defense Leasing Review Panel, "Multiyear Leasing of Capital Assets," November 1, 2001, that identified the role of the Leasing Review Panel in the Defense Acquisition Board review process.

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**DoD Directive 5000.1.** DoD Directive 5000.1 states that the Defense Acquisition Executive, who is the Under Secretary of Defense for Acquisition, Technology, and Logistics, is responsible for supervising the Defense Acquisition System. It further states that the milestone decision authority for a program has the authority to approve entry of an acquisition program into the next phase of the acquisition process and is accountable for cost, schedule, and performance reporting to higher authority, including Congressional reporting. Also, DoD Directive 5000.1 states that program managers will manage programs consistent with statute and regulatory requirements.

**DoD Instruction 5000.2.** DoD Instruction 5000.2 requires that the Defense Acquisition Board advise the Under Secretary of Defense for Acquisition, Technology, and Logistics on critical acquisition decisions for major Defense acquisition programs, such as the Boeing KC-767A Tanker Program. In this respect, the Instruction requires that the following documentation requirements be completed and reviewed by the Defense Acquisition Board at program initiation:

- Initial Capabilities Document
- Analysis of Alternatives
- Capability Development Document
- Affordability Assessment
- Acquisition Strategy
- Independent Cost Estimate and Manpower Estimate
- Acquisition Program Baseline
- Information Support Plan
- Test and Evaluation Master Plan
- Exit Criteria

For the DoD decision to acquire 100 Boeing KC-767A tanker aircraft (which could be considered a low-rate [Milestone C] or full-rate production decision), DoD Instruction 5000.2 requires that the following documentation be completed and reviewed by the Defense Acquisition Board before making those decisions:

- Capability Production Document
- Analysis of Alternatives (updated as necessary)
- Affordability Assessment
- Acquisition Strategy
- Independent Cost Estimate and Manpower Estimate
- Acquisition Program Baseline (updated as necessary)
- Information Support Plan
- Operational Test Agency Report
- Exit Criteria

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The importance of the required program documentation in the program decision making process was discussed earlier in the Internal Controls section of the report.

**Memorandum for the Office of the Secretary of Defense Leasing Review Panel.** The empowering memorandum for the Office of the Secretary of Defense Leasing Review Panel, "Multiyear Leasing of Capital Assets," states that the role of the Leasing Review Panel is to advise and assist the Secretary of Defense in evaluating the financial and budget implications of leasing proposals submitted by the Military Departments that are projected to cost a total of \$250 million or more over the life of the lease. It also stated that the Leasing Review Panel is subordinate to Defense Acquisition Board activities. In instances when leasing proposals are being considered as alternatives to potential major Defense acquisition programs, the Panel will make recommendations to the Defense Acquisition Executive concerning the financial efficacy of the proposed lease.

**Air Force Instruction 63-101.** Air Force Instruction 63-101 states that the Assistant Secretary of the Air Force for Acquisition is the senior corporate operating official for acquisition, the Air Force Acquisition Executive, who is responsible for overseeing Air Force acquisition activities. The Instruction further states that the Assistant Secretary of the Air Force for Acquisition makes decisions on program issues, directs the program, sets Air Force acquisition policy, and is the source selection authority for major Defense acquisition programs that are delegated to the Air Force for decision authority by the Under Secretary of Defense for Acquisition, Technology, and Logistics.

#### **Who Was Accountable?**

**Mr. Aldridge.** Mr. Edward C. "Pete" Aldridge, Jr., Under Secretary of Defense for Acquisition, Technology, and Logistics was accountable for making the decision not to comply with statutory and regulatory requirements in DoD Instruction 5000.2. Although we were unable to interview Mr. Aldridge, Dr. Sambur, Assistant Secretary of the Air Force for Acquisition advised that, in November 2001, Mr. Aldridge told him that the requirements of DoD Directive 5000.1 did not need to be implemented for the Boeing KC-767A tanker aircraft lease. Although this decision was not documented, Mr. Aldridge's actions did not show that he intended for the Air Force to comply with the statutory and regulatory requirements in DoD Directive 5000.1.

**Mr. Wynne.** Mr. Michael W. Wynne, Acting Under Secretary of Defense for Acquisition, Technology, and Logistics was accountable for tacitly accepting Mr. Aldridge's decision to go forward with the Boeing KC-767A tanker aircraft lease by sending a memorandum discussing the decision to an Office of Management and Budget official on May 28, 2003. In the memorandum, Mr. Wynne stated that, "After a comprehensive and deliberative review by the Leasing Review Panel, the Secretary of Defense has approved the Air Force's proposal to enter into a multiyear Pilot Program for leasing general purpose Boeing 767 aircraft under the authority in section 8159 of the Department of Defense Appropriations Act of FY 2002." The memorandum was seeking approval of the proposed lease from the Office of Management and Budget. At that point in time, the Leasing Review Panel had not completed their deliberations

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or made recommendations to Mr. Aldridge concerning the decision to go forward with the lease proposal. In addition, Mr. Wynne previously had expressed concerns with the Air Force's negotiated unit price for the Boeing KC-767A tanker aircraft lease proposal.

**Dr. Roche.** Dr. James G. Roche, Secretary of the Air Force stated that he was responsible for making the decision in August 2003 to not perform an analysis of alternatives as required in DoD Instruction 5000.2.

**Dr. Sambur.** Dr. Marvin R. Sambur, Assistant Secretary of the Air Force for Acquisition was also accountable for not making the decision to comply with statutory and regulatory requirements in DoD Directive 5000.1. Regardless of Mr. Aldridge's advice, Dr. Sambur was responsible, as the Air Force Acquisition Executive, for exercising his fiduciary responsibilities to the DoD and the American taxpayer by ensuring that best practices and prudent acquisition procedures were implemented to provide sufficient accountability for the expenditure of \$23.5 billion for the Boeing KC-767A tanker aircraft lease.

**Ms. Druyun.** Ms. Darleen A. Druyun, Principal Deputy Assistant Secretary of the Air Force (Acquisition and Management) was also accountable for not making the decision to comply with statutory and regulatory requirements in DoD Directive 5000.1. Ms. Druyun, in actively directing and overseeing System Program Office activities in managing the Boeing KC-767A tanker aircraft lease before her retirement, was accountable for ensuring that best practices and prudent acquisition procedures were implemented.

## **Deciding that the Boeing KC-767A Tanker Aircraft Are Commercial Items**

**Who within the Office of the Secretary of Defense and the Air Force was responsible for making the decision that the Boeing KC-767A tanker aircraft was a commercial item?**

### **Issue**

The Air Force contracting officer decided to use a commercial item procurement strategy that Air Force management strongly encouraged for the sole-source Boeing KC-767A Tanker Program. However, contrary to the Air Force interpretation, the military tanker aircraft is not a commercial item as defined in Section 403 of Title 41, United States Code. Further, a commercial market for the Boeing KC-767A tanker aircraft did not exist to establish the reasonableness of prices by forces of supply and demand.

By using a commercial item procurement strategy, the Air Force was also required to use a fixed-price type contract where the contractor retains all of the savings if the contractor's actual costs are lower than the estimates rather than a more appropriate mix of cost and fixed-price incentive type contracts. The commercial strategy also exempted Boeing from the requirement to submit cost or pricing data, which places the Government at high risk for paying excessive prices and profits and precludes good fiduciary responsibility for DoD Funds.

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Without the Air Force gaining insight into Boeing's actual costs, the Air Force will also be at disadvantage in any future tanker procurement negotiations. See Department of Defense Office of the Inspector General Report No. D-2004-064, "Acquisition of the Boeing KC-767A Tanker Aircraft," March 29, 2004, for further details.

### **Policy**

Federal Acquisition Regulation Part 2, "Commercial Item Definition," Part 12, "Acquisition of Commercial Items," and Part 15, "Contracting by Negotiation;" Section 403 of title 41, United States Code, "Definitions" (Commercial items); Under Secretary of Defense for Acquisition, Technology, and Logistics memorandum on "Commercial Acquisitions," January 2001, "the Federal Acquisition Streamlining Act of 1994" or "FASA," and Section 2306a of title 10, United States Code, "Cost or pricing data: truth in negotiation," provide guidance on commercial items and exceptions to obtaining cost or pricing data.

The Federal Acquisition Streamlining Act of 1994 and the Federal Acquisition Reform Act of 1996 streamline acquisition laws, facilitate the acquisition of commercial products, and eliminate unnecessary statutory impediments to efficient and expeditious acquisition. One impact of the Acts was to significantly broaden the commercial item definition and allow more items to qualify for the "commercial item" exception to cost or pricing data. The Truth in Negotiations Act of 1962 allows DoD to obtain cost or pricing data (certified cost information) from Defense contractors to ensure the integrity of DoD spending for military goods and services that are not subject to marketplace pricing.

In June 1995, the Director, Defense Procurement provided comments on the benefits of the Truth in Negotiations Act, marketplace pricing, and the differences between DoD and commercial procurement environments. He stated that:

The requirements of TINA [Truth in Negotiations Act] are necessary to ensure the integrity of DoD spending for military goods and services that are not subject to marketplace pricing. When there is a market that establishes prices by the forces of supply and demand, the market provides the oversight. DoD procures many highly complex military systems in the absence of supply/demand situations for these relatively low volume, unique military goods. The requirements of TINA address legitimate and necessary differences between DoD and commercial procurement environments.

While DoD recognizes the need for TINA, it also is moving to increase competition and decrease the number of pricing actions that would require cost or pricing data. The implementation of FASA [Federal Acquisition Streamlining Act], with its emphasis on encouraging the acquisition of commercial end items and increased competition, will bring the requisite market forces to bear on prices, and thus exempt contractors from the requirement to submit cost or pricing data. Absent this competition, the quantitative benefit to the Government of TINA compliance far exceeds the cost of Government oversight.

Over the last 7 years, the Department of Defense Office of Inspector General has issued a series of reports that identified problems DoD contracting officers were having making commercial item determinations and using catalog prices and price

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analysis to determine fair and reasonable prices for sole-source commercial and noncommercial spare parts. The audits consistently showed that little, if any, commercial marketplace identical or "of a type" items existed and that contracting officers relied on either catalog prices or price analysis to determine price reasonableness. Based on cost information (cost analysis) that was not made available to the contracting officers, the audits showed that commercial and noncommercial prices were significantly too high.

#### **Who Was Accountable?**

**Air Force Acquisition Officials.** Air Force acquisition officials, including Dr. Roche; Dr. Sambur; General John P. Jumper, Air Force Chief of Staff; Ms. Druyun; Major General Paul Essex, Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition); [REDACTED] Office of the Air Force Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) and most senior Air Force officials strongly encouraged the contracting officer to use a commercial item procurement strategy for the Boeing KC-767A Tanker Program to comply with the requirements for an operating lease. If the military tanker aircraft could not be classified as a commercial item, the Air Force could not use an operating lease, and the program could not proceed as defined in the legislation.

b(6)

[REDACTED] the contracting officer at the Aeronautical Systems Center inappropriately determined that the Boeing KC-767A military tanker aircraft was a commercial item and inappropriately signed the "Commercial Determination for the KC-767A Aircraft System."

b(6)

[REDACTED] Air Force Materiel Command Law Office reviewed and approved the contracting officer's commercial item determination and finding, and stated that:

b(6)



b(5)

**Mr. Hughes.** Mr. James "Ty" Hughes, Office of the Air Force General Counsel, also reviewed and did not take exception to the contracting officer's commercial item determination and finding that the Boeing KC-767A tanker aircraft was a commercial item.

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## **Deciding that the Boeing KC-767A Tanker Aircraft Met Operating Lease Requirements**

**Who within the Office of the Secretary of Defense and the Air Force was responsible for making the decision that the Boeing KC-767A tanker aircraft lease proposal met Office of Management and Budget Circular No. A-11 operating lease requirements and Office of Management and Budget Circular No. A-94?**

### **Issue**

The contract lease for 20 Boeing KC-767A tanker aircraft did not meet three of the six criteria requirements for an operating lease as described in Office of Management and Budget Circular No. A-11, "Preparation, Submission, and Execution of the Budget (2003)." Meeting the Office of Management and Budget criteria for leases is a statutory requirement of Section 8159 of the Department of Defense Appropriations Act for FY 2002. Further, Office of Management and Budget Circular No. A-11 requirements for the use of an operating lease and Office of Management and Budget Circular No. A-94 requirements for cost benefit analysis (net present value) were not met. In addition, the Air Force long-term lease was contrary to the actual intended use of operating leases, which may be cost effective when the Government has only a temporary need for the asset. Accordingly, the lease for the Boeing KC-767A tanker aircraft was incorrectly classified as an operating lease. In addition, the use of an operating lease for long-term use is a high-cost way to acquire a capital asset. See Department of Defense Office of the Inspector General Report No. D-2004-064 for further details.

On May 22, 2003, Ms. Robin Cleveland, Office of Management and Budget notified Boeing that Boeing KC-767A tanker aircraft lease proposal met Office of Management and Budget Circular No. A-11 operating lease requirements and Office of Management and Budget Circular No. A-94 cost-benefit analysis requirements "deal done." The Office of the Secretary of Defense Leasing Review Panel officials stated that they relied upon Office of Management and Budget for making the determination as to whether the Boeing KC-767A tanker aircraft lease proposal met Office of Management and Budget Circular No. A-11 operating lease requirements.

On May 23, 2003, Mr. Aldridge signed the "Air Force Boeing 767 Tanker Lease Decision Memorandum," stating that "The Secretary of Defense approved this lease proposal contingent upon securing a waiver of the requirement to fund termination liability and approval of the Office of Management and Budget."

On June 20, 2003, the Director, Program Analysis and Evaluation sent a memorandum to the Acting Under Secretary of Defense for Acquisition, Technology, and Logistics that stated his office's analysis of Office of Management and Budget Circular No. A-94 showed that the provisions of the draft Boeing KC-767A tanker lease proposal cost more than the equivalent purchase of tanker aircraft by \$6.0 billion measured in then-year dollars and \$5.1 billion if measured in constant FY 2002 dollars. His office's analysis also



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showed that the current draft lease failed to meet the requirement in Office of Management and Budget Circular No. A-11 that the present value of the lease payments be less than 90 percent of the fair market value at lease inception.

**Policy.** Office of Management and Budget Circular Nos. A-11, "Preparation, Submission, and Execution of the Budget (2003)," and A-94, "Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs," provide guidance on operating leases.

To qualify as an operating lease, the Air Force lease for the Boeing KC-767A tanker aircraft must meet the six criteria, as described in Office of Management and Budget Circular No. A-11:

- The asset is a general-purpose asset rather than being for a special purpose of the government and is not built to the unique specification of the government as lessee;
- There is a private-sector market for the asset;
- The present value of the minimum lease payments over the life of the lease does not exceed 90 percent of the fair market value of the asset at the beginning of the lease term;
- The lease does not contain a bargain-price purchase option;
- Ownership of the asset remains with lessor during the term of the lease and is not transferred to the government at or shortly after the end of the lease term; and
- The lease term does not exceed 75 percent of the estimated economic life of the asset.

If the lease does not meet all six criteria, the lease should be considered either a capital lease or a lease purchase. A lease purchase is a lease where ownership of an asset is transferred to the Government at or shortly after the end of the lease term but does not have to include a bargain-price purchase option. A capital lease is different from an operating lease in that the Government consumes most of the useful life of the asset. For either a capital lease or a lease purchase, the Air Force would have to have funds budgeted in the Future Years Defense Program to pay for the asset lease. Further, to qualify under Office of Management and Budget Circular No. A-94, in net present value terms, the cost of the operating lease must be less than or equal to the cost to purchase the aircraft.

#### **Who Was Accountable?**

**Dr. Sambur.** Dr. Sambur, Assistant Secretary of the Air Force (Acquisition) was accountable for decisions made to manipulate the lease terms to demonstrate the satisfaction of operating lease criteria requirements in Office of Management and Budget Circular No. A-11. For example, in February 2003, Dr. Sambur, in reference to the price comparison between leasing or purchasing Boeing KC-767A tanker aircraft, directed his staff to remove in the purchase comparison the use of multiyear contracting. He stated on the purchase side, DoD would not be able to enter a multiyear contract similar to the lease. This direction skewed

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the Air Force's results of the price comparison between purchasing or leasing the aircraft and closed the Air Force price differential between the two options.

**Ms. Druyun.** Ms. Druyun, the Principal Deputy Assistant Secretary of the Air Force (Acquisition and Management) was accountable for manipulating the Congressional language on leasing tankers. In December 2001, she notified a Representative and congressional staff that the proposed language of leasing tankers was not executable. The leasing language was not executable because of the Congressional Budget Office position on scoring the lease as a capital lease. The proposed language required the lease of "green aircraft" (basic Boeing 767 aircraft) and then modification through a separate appropriation. She recommended that the congressional language be modified to describe the lease for "commercial aircraft tanker" versus "green" Boeing 767 aircraft because the Air Force did not have the money for the modification and would not meet the 90 percent fair market value rule. Ms. Druyun had [REDACTED] Office of the Air Force Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition), who controlled the lease analysis, report to her and Major General Essex, Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition).

b(6)

## **Proposing to Lease Boeing KC-767A Tanker Aircraft**

**Who within the Air Force was responsible for making the decision to propose leasing Boeing KC-767A tanker aircraft?**

### **Issue**

Recapitalization of tanker aircraft was not a budget priority, yet the Air Force, with support from certain Senators and Representatives as well as three of the four congressional Defense committees, supported the lease of Boeing KC-767A tanker aircraft.

### **Policy**

Chairman of the Joint Chief of Staff Instruction 3170.01D, "Joint Capabilities Integration and Development System," March 12, 2004, requires that:

- the Joint Capabilities Integration and Development System analysis process document capability gaps,
- determine the attributes of a capability or combination of capabilities that would resolve the gaps, and
- identify material and or nonmaterial approaches for implementation and roughly assess the cost and operational effectiveness of the joint force for each of the identified approaches in resolving capabilities gaps.

Before program initiation, the Instruction requires the Military Departments to prepare an initial capabilities document to make the case to establish the need for a material approach to resolve a specific capability gap, or set of capability gaps,

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derived from the Joint Capabilities Integration and Development System analysis process. The initial capabilities document supports the preparation of an analysis of alternatives.

#### **Who Was Accountable?**

**Dr. Roche.** Dr. Roche, Secretary of the Air Force made the decision to make the leasing of Boeing KC-767A tanker aircraft as one of his vision items. Accordingly, he signed and sent a letter that Ms. Druyun had drafted to a Representative indicating the need for “jump-starting” a replacement program for the KC-135 tanker aircraft fleet by leasing.

**Ms. Druyun.** Ms. Druyun, the Principal Deputy Assistant Secretary of the Air Force (Acquisition and Management) made the decision to promote the leasing of tanker aircraft. In September 2001, Ms. Druyun stated that the Air Force favored leasing Boeing KC-767A tanker aircraft rather than purchasing because the budget did not contain money for purchasing Boeing KC-767A tanker aircraft and a lease deal was favorable to a certain Senator and Representative. Boeing helped Ms. Druyun with a briefing for the Senator on leasing that illustrated the need to waive legal impediments and provide relief under Office of Management and Budget Circular No. A-11 criteria requirements. In October 2001, Ms. Druyun had a letter drafted for Dr. Roche’s signature to be sent to a Representative indicating the need for “jump-starting” a replacement program for the KC-135 tanker aircraft fleet by leasing. Ms. Druyun’s actions took place before the approval of a mission need statement and the preparation of an operational requirements documents (predecessor documents to the initial capabilities document) supporting the need to fill a capabilities gap (a validated urgent need for replacement tankers) as required in Chairman of the Joint Chief of Staff Instruction 3170.01D.

### **Need to Accelerate the Recapitalization of the KC-135 Tanker Aircraft Fleet**

**Was there an urgent and compelling need to accelerate the recapitalization of the KC-135 tanker fleet?**

#### **Issue**

DoD and Air Force acquisition officials determined that an urgent and compelling need existed to accelerate the recapitalize the KC-135 tanker aircraft fleet after legislation was signed that allowed the lease of up to 100 Boeing KC-767A tanker aircraft. The Air Force managers used corrosion problems and higher than expected maintenance costs as their reason to accelerate the recapitalization effort. However, independent reviews and other testimony on the KC-135 tanker aircraft fleet, such as the Defense Science Board, did not support the need to accelerate the recapitalization of the tanker fleet.

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## **Policy**

The Federal Acquisition Regulation states that acquisition planning should begin as soon as the agency need is identified but requirements personnel should avoid issuing requirements on an urgent basis since it generally restricts competition and increases prices.

DoD Instruction 5000.2 states that the program manager and milestone decision authority may tailor the phases and decision points for a program due to risk and urgency of need.

## **Who was Accountable?**

**Mr. Aldridge.** Mr. Aldridge, Under Secretary of Defense for Acquisition, Technology, and Logistics was accountable because he signed the "Air Force Boeing 767 Tanker Lease Decision Memorandum" on May 23, 2003. The memorandum gave the Air Force conditional approval to enter into a multiyear lease pilot program for leasing general purpose Boeing 767 aircraft. Mr. Aldridge also stated that the combined effects of aging and the surge in demand due to the Global War on Terrorism have increased the need to replace the KC-135 tanker aircraft. Although the lease was more expensive, Mr. Aldridge preferred the lease because it would accelerate the delivery of the first new tanker and minimized the financial impact to other on-going programs.

**Mr. Wynne.** Mr. Wynne, Acting Under Secretary of Defense for Acquisition, Technology, and Logistics accountable because he issued a memorandum on May 28, 2003, which was almost identical to Mr. Aldridge's "Air Force Boeing 767 Tanker Lease Decision Memorandum," to notify the Office of Management and Budget regarding the Office of Secretary of Defense decision to lease the Boeing KC-767 tanker aircraft.

**Dr. Roche.** Dr. Roche, Secretary of the Air Force was accountable because he disagreed with the Air Force's plan to begin the recapitalize of the KC-135 tanker aircraft beginning in 2013. Dr. Roche wanted to begin recapitalizing the tanker fleet sooner because of the opportunity to lease the Boeing KC-767A tanker aircraft presented in legislation. Dr. Roche testified numerous times regarding the urgency to recapitalize the KC-135 tanker aircraft fleet because of severe corrosion problems and the increased maintenance costs. Dr. Roche stated that the previous studies conducted on the KC-135 tanker aircraft fleet were faulty and that the cost to sustain the KC-135 tanker aircraft fleet was significantly increasing and approximately 30 percent for depot maintenance hours were dedicated to fixing corrosion. Dr. Roche stated that the Air Force had done a comprehensive and deliberate review that both validated the urgent need to start modernizing our tankers now and the advantages of leasing; however, the Air Force was not able to provide any supporting details supporting Dr. Roche's position. Dr. Roche subsequently recognized that an urgent and compelling need to expedite the recapitalization of the KC-135 tanker aircraft fleet did not exist.

**Dr. Sambur.** Dr. Sambur, Assistant Secretary of the Air Force (Acquisition) was accountable because he was the Air Force acquisition executive and knew that an urgent requirement to recapitalize the KC-135 tanker aircraft fleet did not exist

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because of corrosion and maintenance costs growth; however, he supported those claims. Dr. Sambur acknowledged to Dr. Roche in October 2002 that the Air Force did not have an urgent need to expedite the replacement the KC-135 tanker aircraft and needed a reason to justify the lease of the Boeing KC-767A tanker aircraft. Dr. Sambur understood that the Air Force could fix the corrosion problems identified in the KC-135 tanker aircraft fleet and that depot maintenance would take between six and nine months for each KC-135 tanker aircraft. Dr. Sambur also implied that the Boeing KC-767A tanker aircraft lease was as an insurance policy for the Department in the event that the KC-135 tanker aircraft fleet experienced unexpected significant mission failures. Dr. Sambur stated that, if the Department waited until corrosion was a lethal problem and airplanes were falling out of the sky, then the recapitalization effort would be too late. Further, he stated that the Air Force would need 10 years to recapitalize, even a 100 tanker aircraft. Dr. Sambur recognized the inconsistency in his claim because after testifying that the Air Force was not seeing the same type of problems in the KC-135R tanker aircraft models and the Air Force planned to retire some of its KC-135E tanker aircraft models even without leasing the Boeing KC-767A tanker aircraft as replacements for the KC-135E tanker aircraft models.

**General Jumper.** General Jumper, Chief of Staff of the Air Force was accountable for supporting the Air Force sense of urgency to initiate the lease of the KC-767A tanker aircraft. General Jumper believed that the lease was a pilot program and would be difficult to execute so the Air Force accepted the risk that the program may not work. From the beginning, General Jumper believed that, if the Boeing KC-767A tanker aircraft lease did not work, then the Air Force would resume the program of record to recapitalize the KC-135 tanker aircraft fleet starting in 2013.

**Major General Essex.** Major General Essex, Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) was accountable for the sense of urgency associated with corrosion because he testified on the health of the KC-135 tanker aircraft fleet. Major General Essex stated that the Air Force was in denial early on about the KC-135 tanker aircraft corrosion problem and that the economic service life study portrayed an optimistic picture of the KC-135 tanker aircraft corrosion problem and repair costs. Major General Essex stated that the Air Force did a thorough review in early 2002 and recalculated all the costs associated with maintenance of the KC-135 tanker aircraft fleet. However, the Air Force was unable to provide support for the recalculated costs.

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## **Performing an Analysis of Alternatives on the KC-135 Tanker Aircraft Recapitalization**

**Who within the Department of Defense and the Air Force was responsible for making the decision to forego performing an analysis of alternatives on the KC-135 tanker recapitalization effort?**

### **Issue**

DoD and Air Force leadership and acquisition officials did not prepare an analysis of alternatives before accepting the Boeing KC-767A tanker aircraft as the materiel solution to recapitalization of the aerial refueling tanker fleet. An analysis of alternatives was not conducted because:

- the language of the Section 8159 of the Department of Defense Appropriations Act for FY 2002 provided a materiel solution to the KC-135 tanker aircraft recapitalization effort;
- conducting an analysis of alternatives would delay the recapitalization effort by a year and a half to two more years and with the opinion of Dr. Roche, produce the same materiel solution; and
- an informal analysis could substitute for the more formal analysis of alternatives.

### **Policy**

DoD Instruction 5000.2, Chairman of the Joint Chiefs of Staff Instruction 3170.01D, "Joint Capabilities Integration and Development System", March 12, 2004, and Air Force Instruction 10-601, "Capabilities Based Requirements Development", July 30, 2004, provide guidance concerning an analysis of alternatives.

**DoD Instruction 5000.2.** DoD Instruction 5000.2 states that an analysis of alternatives is required for all major Defense acquisition programs at Milestone A, Milestone B, and Milestone C (updated as necessary). Further, the Instruction requires the DoD Component to designate responsibility for completion of the analysis of alternatives, but it may not be assigned to the program manager. The milestone decision authority for Acquisition Category ID programs is the Under Secretary of Defense for Acquisition, Technology, and Logistics.

**Chairman of the Joint Chiefs of Staff Instruction 3170.01D.** Chairman of the Joint Chiefs of Staff Instruction 3170.01D requires that an analysis of alternatives to be conducted for all potential Acquisition Category I programs after the approval of the initial capabilities document to refine the initial materiel approach recommended for implementation in the initial capabilities document. Chairman of the Joint Chiefs of Staff Instruction 3170.01D requires the Under Secretary of Defense for Acquisition, Technology, and Logistics to be engaged early to ensure that the analysis plan adequately addresses a sufficient range of materiel approaches.

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**Air Force Instruction 10-601.** Air Force Instruction 10-601 requires that, in the case of a potential Acquisition Category I proposal, an analysis of alternatives must be conducted in accordance with DoD Instruction 5000.2.

#### **Who Was Accountable**

**Mr. Aldridge.** Mr. Aldridge, Under Secretary of Defense for Acquisition, Technology, and Logistics was accountable for making the decision to not to comply with the statutory and regulatory requirements in DoD Directive 5000.1. Although we were unable to interview Mr. Aldridge, Dr. Sambur stated that Mr. Aldridge told him that the requirements of DoD Directive 5000.1 did not need to be implemented for the Boeing KC-767A tanker aircraft lease. Mr. Aldridge made the decision to lease Boeing KC-767A tanker aircraft without the benefit of an analysis of alternatives when he authored his Leasing Decision Memorandum. Mr. Aldridge's actions showed that he did not intend the Air Force to comply with the statutory and regulatory requirements of the DoD Directive 5000.1.

**Mr. Wynne.** Mr. Wynne, Acting Under Secretary of Defense for Acquisition, Technology, and Logistics was also accountable for making the decision to forego the analysis of alternatives. As Acting Under Secretary of Defense for Acquisition, Technology, and Logistics, Mr. Wynne had a responsibility of ensuring the analysis plan adequately addresses a sufficient range of materiel approaches. Mr. Wynne upon assuming the position of Acting Under Secretary of Defense for Acquisition, Technology, and Logistics continued execution of the Boeing KC-767A tanker aircraft lease effort without the benefit of an analysis of alternatives.

**Dr. Roche.** Dr. Roche, Secretary of the Air Force was accountable for making the decision to forego the analysis of alternatives. In August 2003, Dr. Roche directed Major General Wayne Hodges, Director of Global Reach, Office of the Secretary of the Air Force (Acquisition) to halt the effort by the Office of the Assistant Secretary of the Air Force (Acquisition) to conduct the analysis of alternatives. As early as November 2002, Dr. Roche felt that conducting an analysis of alternatives would not be beneficial to the Boeing KC-767A tanker aircraft lease, as it would inhibit the progress of the leasing deal with Boeing. In addition, Dr. Roche felt that the pilot program designation of the KC-767A tanker aircraft lease deal, excused the Air Force from following the statutory and regulatory provisions in DoD Directive 5000.1. Moreover, an analysis of alternatives was not conducted because the language of Section 8159 had already specified the Boeing KC-767A tanker aircraft as the materiel solution. Dr. Roche felt that an analysis of alternatives became unnecessary because the Air Force was only complying with the language of the legislation.

**Dr. Sambur.** Dr. Sambur, Assistant Secretary of the Air Force (Acquisition) was accountable for supporting the decision to forego the analysis of alternatives. Even though Mr. Aldridge told Dr. Sambur that the requirements of DoD Directive 5000.1 did not need to be implemented for the Boeing KC-767A tanker aircraft lease, Dr. Sambur was responsible, as the Air Force Acquisition Executive, for exercising best practices and prudent acquisition procedures to

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ensure the justification and the reasonableness of the \$23.5 billion expenditure for the Boeing KC-767A tanker aircraft lease.

**Major General Essex.** Major General Paul Essex, Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) from April 2001 to January 2003, was accountable for accepting the decision to forego the analysis of alternatives. His office was primarily responsible for being the link between the acquisition community and the operating command. Major General Essex also used the language of Section 8159 as a means of jump starting the KC-135 recapitalization effort without identifying any alternatives to the desired capability.

**Major General Hodges.** Major General Wayne Hodges, Director of Global Reach, Office of the Secretary of the Air Force (Acquisition) was accountable for accepting the decision to forego the analysis of alternatives. Because of the language in Section 8159, Major General Hodges assumed that an analysis of alternatives was not required because the language specifically stated that the Air Force was to lease Boeing KC-767A tanker aircraft.



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## **Part III – What Actions Must Be Taken to Prevent a Situation Like the Tanker Lease From Happening Again?**

### **Cultural Change**

The Office of Management and Budget circulars, the Federal Acquisition Regulation, and the DoD 5000 series of guidance establish a system of management controls over the acquisition of weapon systems for the Department. The system, when properly implemented and followed, should place needed capabilities in the hands of the warfighter while appropriately mitigating the level of risk associated with properly performing the actual functions expected of the weapon system. Also, the 5000 series establishes a system of management controls to maintain proper financial control of the program to protect the interests of both the warfighter and the taxpayer when contemplating different weapons acquisition strategies to include leasing as a financing option. The system of management internal controls were either not in place or not effective because the existing acquisition procedures were not followed in the proposed lease of the Boeing KC-767A tanker aircraft. The Department of Defense must change the cultural environment in its acquisition community to ensure that the proper control environment is reestablished and followed for major weapon-system acquisitions.

In addition, as part of the cultural change, the senior leadership of the Department must not tolerate situations where senior officials use their positions to have contractors put pressure on other senior officials to have them change their stance relative to a particular situation. For example, on June 20, 2003, Mr. Kenneth J. Krieg, Director, Program Analysis and Evaluation issued a memorandum stating that purchase was more cost effective than leasing the Boeing KC-767A tanker aircraft and that the lease as proposed did not meet Office of Management and Budget requirements. According to Boeing executives in an e-mail, Dr. Roche subsequently requested, in a meeting with them on June 23, 2003, that Boeing put pressure on Mr. Wynne to have Mr. Krieg change his position on the Boeing KC-767A tanker aircraft lease.

### **Regulatory Options**

Even though Department of Defense Instruction 5000.2, "Operation of the Defense Acquisition System," May 12, 2003, requires an analysis of alternatives at major milestone decision points for major defense acquisition programs, the Office of the Secretary of Defense and the Department of the Air Force did not comply with the requirement because of guidance from Mr. Aldridge to Dr. Sambur that the requirements of DoD Directive 5000.1 did not need to be implemented for the Boeing KC-767A tanker aircraft lease. Therefore, the Secretary should reemphasize the requirement to conduct an analysis of

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alternatives for all major Defense acquisition programs and major systems before major milestone decision points.

Further, the Deputy Secretary of Defense should require the Under Secretary of Defense for Acquisition, Technology, and Logistics; the Assistant Secretary of Defense for Networks and Information Integration; and the Director, Operational Test and Evaluation to revise Department of Defense Instruction 5000.2 to specify the procedures the Under Secretary of Defense for Acquisition, Technology, and Logistics; and the Department of Defense Component Acquisition Executives must follow when leasing a major Defense acquisition program or a major system. Specifically, the guidance should emphasize that leasing is a method for financing the acquisition of a program and that the program should be treated the same as any acquisition program of like cost. Further, the guidance should require, at a minimum, that the acquiring Military Department prepare an analysis of alternatives for the lease and that the decision to enter into a contract to lease a major Defense acquisition program or a major system must be subject to the results of a Defense Acquisition Board or a System Acquisition Review Council review, as applicable.

## **Assessment Recommendations**

The Secretary of Defense should instruct his staff to monitor implementation of the recommendations that the Defense Acquisition University made in its September 3, 2004, report in response to tasking memorandum, "Lessons Learned from the Independent Assessments of Proposed 767 Tanker Lease Buy," that the Acting Under Secretary of Defense for Acquisition, Technology, and Logistics issued on May 25, 2004.

Using the results of reviews of the Boeing KC-767A Tanker Program by the Defense Science Board, the Industrial College of the Armed Forces, and the Department of Defense Office of the Inspector General, the Defense Acquisition University concluded that policy for commercial item acquisitions and the leasing process needed clarification. Specific recommendations included several proposed policy changes in the areas of Acquisition Management and Oversight, Commercial Item Policy and Leasing Policy. The Under Secretary of Defense for Acquisition, Technology, and Logistics adopted all of the proposed recommendations and is in the process of implementation. The most significant of the proposed recommendations were that the Under Secretary of Defense for Acquisition, Technology, and Logistics:

- Follow DoD Instruction 5000.2 oversight, review, and decision processes - Cancel Leasing Review Panel;
- Change the Federal Acquisition Regulation and the Defense Federal Acquisition Regulation Supplement to clarify the authority of the contracting officer to obtain all necessary cost information needed to determine prices are fair and reasonable in commercial item acquisitions;

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- Develop specific guidance for analyzing whether a significant military unique modification effects a commercial item determination and for determining a fair and reasonable price for the modified item;
  - Rewrite the Commercial Item Handbook to incorporate recent changes resulting from legislation and best practices; and
  - Evolve the Department's existing body of knowledge for the management of major systems to include systems acquired using Federal Acquisition Regulation Part 12.

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## Appendix A. Related Coverage

Since January 10, 2002, when the Department of Defense Appropriations Act for FY 2002, Section 8159 authorized the Air Force to make payments on a multiyear pilot program for leasing general purpose Boeing 767 aircraft in a commercial configuration, the Department of Defense Office of the Inspector General has conducted three analyses of the Boeing KC-767A Tanker Program. Those analyses were in response to requests by the Chairman, Committee on Commerce, Science, and Transportation, U.S. Senate; the Acting Under Secretary of Defense for Acquisition, Technology, and Logistics; and the Deputy Secretary of Defense.

**Chairman Request.** On April 17, 2002, the Chairman, Committee on Commerce, Science, and Transportation requested that we assess the Air Force decision to select the Boeing 767 rather than the Airbus 330 for its air refueling tankers. On May 3, 2002, the Department of Defense Inspector General issued a memorandum, stating that the Air Force did not fully accomplish the purpose of Federal Acquisition Regulation Subpart 15.201, "Exchanges With Industry Before Receipt of Proposals," which was to improve the understanding of Government requirements and industry capabilities through the exchange of information with potential offerors. However, because Section 8159 of the Department of Defense Appropriations Act for FY 2002 specified Boeing aircraft, the Air Force stated that the normal processes of a request for information were not necessary. Consequently, we did not take exception to the selection of the Boeing 767, because it was specified in legislation.

**Acting Under Secretary Request.** On July 22, 2003, the Acting Under Secretary of Defense for Acquisition, Technology, and Logistics requested that we:

- review the decision process used by the Air Force and the Office of the Secretary of Defense to lease the Boeing KC-767A Tanker aircraft, and
- assess whether DoD interaction with Congress following the "Air Force Boeing 767 Tanker Lease Decision Memorandum," May 23, 2003, was timely and reasonable.

On August 29, 2003, we issued Department of Defense Office of the Inspector General Report No. D-2003-129, "Assessment of DoD Leasing Actions," stating that, although not required by statute, applying a best business practice of weighing the need to conduct a formal analysis of alternatives to achieve the best possible system solution could have improved the Air Force Leasing process. Further, a best business practice would have been to expand the charter of the Office of the Secretary of Defense Leasing Review Panel to include the Panel's role in the acquisition process and in the life cycles of the leases. We also determined that of the six letters from the Chairman, Committee on Commerce, Science, and Transportation and the one letter from the Congressional Budget Office, five were generally timely and two were not timely. Further, two responses could have been improved by a more comprehensive answer to portions of the requests. However, we did not identify a reason to not proceed with the lease of the Boeing KC-767A Tanker aircraft based on the limited scope of our review.